DOCKET

No. 86-1856-ASX Title: Northwest Central Pipeline Corporation, Appellant
Status: GRANTED v.
State Corporation Commission of Kansas, et al.

Docketed: Court: Supreme Court of Kansas
May 21, 1987

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NOTE: Notice of Appeal filed 3/25/87

Entry	Date	Note	Proceedings and Orders
1	May 21 1987	G	Statement as to jurisdiction filed.
2	Jun 22 1987		Motion of appellee State Corp. Commn. of KS to dismiss or affirm filed.
3	Jun 23 1987		DISTRIBUTED. September 28, 1987
4	Sep 18 1987	X	Reply brief of appellant Northwest Central Pipeline filed.
5	Oct 5 1987	P	The Solicitor General is invited to file a brief in this case expressing the views of the United States.
6	Apr 13 1988		Brief amici curiae of United States, et al. filed.
8	Apr 20 1988		REDISTRIBUTED. May 12, 1988
9	Apr 27 1988	X	Reply brief of appellant Northwest Central Pipeline filed.
11	May 16 1988		REDISTRIBUTED. May 19, 1988
12	May 23 1988		PROBABLE JURISDICTION NOTED.
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13	Jul 7 1988		Joint appendix filed.
14	Jul 7 1988		Lodging received. (9 maps).
15	Jul 7 1988		Brief of appellant Northwest Central Pipeline filed.
17	Jul 18 1988		Order extending time to file brief of appellee on the merits until August 31, 1988.
18	Aug 24 1988		Record filed.
		*	Certified copy of original record, box, received.
21	Aug 30 1988	G	Motion of Interstate Oil Compact Commission for leave to file a brief as amicus curiae filed.
19	Aug 31 1988		Brief amici curiae of United States and FERC filed.
20	Aug 31 1988	G	Motion of Council of State Governments, et al. for leave to file a brief as amici curiae filed.
22	Aug 31 1988		Brief amici curiae of Railroad Commission of Texas, et al. filed.
23	Aug 31 1988		Brief of appellee State Corp. Commn. of KS filed.
24	Sep 12 1988	G	Application (A88-211) to extend the time to file a reply brief from September 30, 1988 to October 30, 1988 by Appellant, submitted to Justice White.
28	Sep 12 1988	G	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
25	Sep 13 1988		CIRCULATED.
27	Sep 13 1988		Application (A88-211) granted by Justice White extending the time to file until October 30, 1988.
31	Sep 30 1988		Set for argument. Tuesday, November 29, 1988. (1st case) (1 hr.)
29	Oct 3 1988		Motion of Interstate Oil Compact Commission for leave to

Entry	Date	Note	Proceedings and Orders
			file a brief as amicus curiae GRANTED.
30	Oct 3 1988		Motion of Council of State Governments, et al. for leave to file a brief as amici curiae GRANTED.
32	Oct 11 1988		Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
33	Oct 31 1988	X	Reply brief of appellant Northwest Central Pipeline filed.
34	Nov 29 1988		ARGUED.

JURISDICTIONAL

STATEMENT

86 1856

Supreme Court, U.S.
FILED
MAY 21 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-

In The Supreme Court Of The United States

OCTOBER TERM, 1986

NORTHWEST CENTRAL PIPELINE CORPORATION,
Appellant,

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, *et al.*,
Appellees.

ON APPEAL AFTER REMAND TO THE SUPREME COURT OF KANSAS

JURISDICTIONAL STATEMENT

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135 pp

QUESTIONS PRESENTED

1. Whether the ruling of the Kansas Corporation Commission, that is designed (i) to cause interstate pipelines to purchase more natural gas from Kansas and less natural gas from other states, and (ii) to cause gas dedicated to interstate commerce to be diverted to Kansas markets, violates the exclusive authority of the Federal Energy Regulatory Commission (i) to regulate the cost structures of interstate gas pipelines, and (ii) to control and regulate abandonments of natural gas dedicated to interstate commerce, in violation of the Supremacy Clause of the United States Constitution.

2. Whether the ruling of the Kansas Corporation Commission, that is designed to cause large volumes of natural gas previously dedicated to interstate commerce to be diverted by force of Kansas law to the Kansas intrastate market, constitutes impermissible state regulation of interstate commerce in violation of the Supremacy and Commerce Clauses of the United States Constitution.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Northern Natural Gas Company, Amoco Production Company, Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation, Kansas Petroleum, Inc., Colorado Interstate Gas Company and K N Energy, Inc. have been appellants together with Northwest Central Pipeline Corporation before the Supreme Court of Kansas. Michael Lennen, Chairman, Richard D. (Pete) Loux, Commissioner, and Phillip R. Dick, Commissioner, and their respective successors, of the State Corporation Commission of the State of Kansas, have appeared in opposition to Northwest Central Pipeline Corporation before the Supreme Court of Kansas.

The following companies also appeared before the State Corporation Commission of the State of Kansas at the initial proceeding:

Southwest Kansas Royalty Owners Association
Mobil Oil Corporation
Northern Natural Gas Producing Company
Federal Land Bank of Wichita
Anadarko Production Company
El Paso Natural Gas Company
Mesa Petroleum Company
Kansas Power and Light Company
Panhandle Eastern Pipeline Company

Kansas-Nebraska Natural Gas Company
Arco Oil and Gas Company
Cities Service Company

Affiliates of Northwest Central Pipeline Corporation (now known as Williams Natural Gas Company) are listed in Appendix J to this Jurisdictional Statement.

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No. 86-

In The Supreme Court Of The United States

OCTOBER TERM, 1986

NORTHWEST CENTRAL PIPELINE CORPORATION,
Appellant,

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, *et al.*,
Appellees.

ON APPEAL AFTER REMAND TO THE SUPREME COURT OF KANSAS

JURISDICTIONAL STATEMENT

Northwest Central Pipeline Corporation (Northwest Central) makes this appeal from the judgment of the Kansas Supreme Court, entered on February 20, 1987, upholding an order of the State Corporation Commission of the State of Kansas in the face of federal constitutional challenges. Appellant submits this statement to show that the Supreme Court of the United States has jurisdiction over the appeal and that a substantial federal question is presented.

OPINIONS BELOW

The opinion of the Kansas Supreme Court dated February 20, 1987 (App. A, *infra*, 1a-12a), is reported at 240 Kan. 638, 732 P.2d 775. The opinion of the Kansas Supreme Court dated May 10, 1985 (App. B., *infra*, 13a-52a), is reported at 237 Kan. 248, 699 P.2d 1002. The opinion of the District Court of Gray County, Kansas (App. C, *infra*, 53a-62a), is not reported. The orders of the Kansas Corporation Commission dated February 16, 1983 (App. D, *infra*, 63a-80a), and April 18, 1983 (App. E, *infra*, 81a-92a), are not reported.

JURISDICTION

This case involves a challenge to the constitutionality of an amendment to Paragraph (p) of the Kansas Corporation Commission's Basic Proration Order for the Kansas Hugoton Gas Field. The Kansas Supreme Court entered its judgment upholding the challenged amendment on February 20, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2). *Atchison, Topeka & Santa Fe Ry. v. Public Utils. Comm'n*, 346 U.S. 346 (1953).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The pertinent provisions are set forth in App. H, *infra*, 93a-104a.

STATEMENT OF THE CASE

The Hugoton Gas Field is said to be the largest known reservoir of natural gas in the world. The Field, as developed, is approximately 160 miles long and from 40 to 72 miles wide. It covers portions of nine counties in Kansas (Kansas Hugoton) and extends across the entire width of the Oklahoma panhandle (Guymon Hugoton) and into portions of several counties of northern Texas (Texas Hugoton). About two-thirds of the Field is located in Kansas. In 1983, there were in excess of 4000 wells located in the Kansas portion of the Hugoton Gas Field.

Most of the gas produced from the Kansas Hugoton Gas Field is transported through large pipelines to other states, including Michigan, Minnesota, Ohio, Illinois, Indiana, Missouri, Colorado and Nebraska. Much of the gas produced from the Oklahoma and Texas portions of the Field is similarly transported through the same large pipeline systems for use in these states. Gas from the Kansas Hugoton Gas Field is commingled in the integrated pipeline system with gas produced from various other fields in other states.

Five major interstate pipelines — Northwest Central Pipeline Company, Northern Natural Gas Company, Panhandle Eastern Pipe Line Company, K N Energy, Inc., and Colorado Interstate Gas Company — have acquired the right to purchase the gas produced from

approximately 90 percent of the Kansas Hugoton wells. *Colorado Interstate Gas Co. v. State Corp. Comm'n*, 192 Kan. 1, 4-7, 386 P.2d 266, 270-71 (1963). The connected reserves of the interstate purchasers in the field are a significant part of their total systemwide reserves.[1]

In 1935, the Kansas legislature enacted a statute entitled "Production and Conservation of Natural Gas." 1935 Kan. Sess. Laws, Ch. 213 (*codified as amended at* Kan. Stat. Ann. § 55-701 *et seq.*). Section 55-703 provides: "[T]he [Kansas Corporation] Commission shall regulate the taking of natural gas from any and all such common sources of supply within this state in order to prevent the inequitable or unfair taking of natural gas from a common source of supply by any person, firm or corporation to prevent unreasonable discrimination * * * in favor of or against any producer in any common source of supply." The purpose of the statute was to modify the so-called "rule of capture" in order to ensure that the several owners of mineral interests in a single field (or "common source of supply") each may

[1]The importance of these reserves to the pipeline companies is evidenced by the fact that the Field has long been a spawning ground for litigation. Much of this litigation has resulted from the Kansas Corporation Commission's historical efforts to intrude upon the exclusive jurisdiction of the FERC (formerly the Federal Power Commission) under the Natural Gas Act, ranging from increasing the price of natural gas at the wellhead by its minimum price orders (invalidated under *Cities Service Gas Co. v. State Corp. Comm'n*, 355 U.S. 391 (1958)), to requiring the pipeline purchasers to take ratably, when the result might be a readjustment of pipeline purcahsing patterns from state to state (invalidated under *Northern Natural Gas Co. v. State Corp. Comm'n*, 372 U.S. 84 (1963)).

receive a fair and equitable portion of the oil and gas available to be produced from the field.

Acting pursuant to this statutory authority, on March 21, 1944, the Kansas Corporation Commission adopted the Basic Proration Order for the Kansas Hugoton Gas Field. The Basic Proration Order provides limits, or "allowables," for production for each well located in the Kansas Hugoton Gas Field. Paragraph (p) of this order historically has provided that any well must be "shut-in" (and production thus curtailed) if the well has overproduced its allowable by a cumulative amount equal to six times its allowable for the month of January. Paragraph (p) also provided (prior to its amendment by the orders that are the subject of this appeal) that if any well fell short of producing its allowable by a cumulative amount equal to six times the prior January allowable, this shortfall would be cancelled and the producer required to apply to the Commission to reinstate the cancelled underage before later making up the shortage. Until the recent action of the Kansas Corporation Commission that gives rise to this appeal, however, Paragraph (p) had further provided that those "cancelled underages":

> "* * * will be reinstated upon verified application therefore, showing that the wells are in an overproduced status; that the purchaser is willing and able to take the amounts of gas; and that the length of time proposed by applicant for the production

of the amounts of gas to be reinstated is reasonable under the circumstances."

App. I, *infra*, 124a. The applications for reinstatement of cancelled underage were routinely granted with no time limit for production.

Since 1963, the Kansas Corporation Commission has attempted to increase the volume of production from the Kansas portion of the Hugoton Field by fixing production allowables far in excess of the market demand for natural gas. That is, the Commission has set allowables far in excess of what producers can produce and sell into the interstate natural gas market. The result has been that huge "underages" developed for most wells connected to *interstate* pipelines in the Kansas Hugoton Gas Field. The wells connected to Northwest Central provide a typical example of the production status for the interstate pipelines, which have witnessed a plummeting interstate gas market. As of June 1985, the wells in the Field connected to Northwest Central were carrying an underage of almost 91.6 billion cubic feet. By contrast, at least one major intrastate pipeline has had sufficient in-state market demand to allow its connected wells to continue in an overproduced status.

The Kansas Corporation Commission's Order of February 16, 1983, amended Paragraph (p) of the Basic Proration Order to provide that underage cancelled before 1975 could be reinstated only if reinstatement

had been requested by the end of 1983. The Amended Paragraph (p) further provided that underages cancelled from January 1, 1975, through December 31, 1982, could only be reinstated if reinstatement was requested by December 31, 1985, and only if the well was in an overproduced status at the time of the request. Finally, with respect to underages cancelled after December 31, 1982, the amendment to Paragraph (p) required the producer to seek reinstatement of the cancelled underages within three years of the cancellation and further required the well to be in an overproduced status at the time of the request. The objectionable part of these amendments to Paragraph (p) is that if the underage is not reinstated within the given periods or if the reinstated underage is not produced within the time permitted by the Corporation Commission, the underage is to be *permanently cancelled* and the affected pipeline thus precluded from purchasing the reserves dedicated to it by contract in the Field.[2]

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[2] The permanent cancellation of underage would cause a *loss of dedicated reserves* in the situation where migration of reserves to adjacent or nearby overproduced wells occurs that is not later offset by compensating cross migration of reserves back to the affected well. Although the question whether this loss of reserves will occur with respect to any single well would require a detailed factual analysis of the circumstances of that well and its surrounding wells, it is clear that this effect will occur with respect to a significant number of wells in the Hugoton Field. *See* App. B, *infra*, 37a. *See also id.* at 50a (Schroeder, C. J., dissenting) ("the result of cancellation under this order will be to • • • no longer permit the corrective or compensatory drainage which was the hallmark of the prior commission order for years. KP&L's intrastate customers will benefit, and Northwest Central interstate customers will be prejudiced.")

The evidence adduced before the Corporation Commission and the District Court revealed that wells with a higher proportionate *intrastate* market demand have been able to produce a greater proportionate part of their gas reserves than the majority of the wells in the Hugoton Field connected to the *interstate* pipelines like Northwest Central. App. B, *infra*, 50a. The direct and immediate result of the permanent cancellation by the Corporation Commission of the interstate pipelines' right to take their proportionate share of gas from the Kansas Hugoton Gas Field is that significant volumes of gas dedicated to interstate commerce will be diverted by force of Kansas law to Kansas intrastate markets rather than being produced into interstate commerce. *See* note 2, *supra*.

The Commission was requested to cure the imbalance between intrastate over-production and interstate under-production by reducing the general production allowables to a rate consistent with overall market demand. App. D, *infra*, 71a. This method was rejected by the Commission because the Kansas intrastate market would then be forced to find sources of gas other than the inexpensive Hugoton Field. App. B, *infra*, 34a-36a. The alternative chosen by the Commission was to keep allowables artificially high so as to serve local interests, and to induce interstate pipelines to take more gas than they can currently transport and market or forever lose their right to take the gas at a later date.

The purpose of the Kansas order, as has been admitted by the Commission's staff in the record below, is to coerce interstate pipeline purchasers to produce greater volumes of gas from the Kansas Field (R. Vol. 9, at 41-44, 71). The Commission itself stated, "It is the purpose of this order not to restrict production of gas but to encourage it." App. D, *infra*, 73a. And the Commission has sought to accomplish this objective even though they recognize that this would necessarily result in these pipelines purchasing less gas from sources in other states (R. Vol. 9, at 94) and would also necessarily subject these pipelines to contract liability and penalties if they fail to perform their purchase contracts in other states (R. Vol. 9, at 96). The Commission has, in fact, admitted that by this order it has intended to assume the authority to dictate how much gas the pipeline purchasers must take in Kansas and, thus, how much of their remaining purchases the pipelines may make in other states (R. Vol. 9, at 48-49).

Northwest Central contested the Corporation Commission's proposal to amend Paragraph (p) at hearings held before the Commission on November 3, 1982, and March 17, 1983. The Corporation Commission ruled, however, that "[t]he contention that the Commission's order of February 16, 1983, changing the provisions of Paragraph (p) of the Hugoton basic order invades the exclusive jurisdiction of the FERC under the Natural Gas Act is without merit." App. E, *infra*, 86a-87a.

Northwest Central appealed the Corporation Commission's order to the District Court of Gray County, Kansas, arguing that the order invaded the exclusive domain of the Federal Energy Regulatory Commission under the Natural Gas Act and impermissibly regulated and burdened interstate commerce. The district court ruled that the order would provide an incentive for gas pipelines to take more gas from the Kansas Hugoton Gas Field, and that the order would pressure interstate pipelines to alter their purchasing patterns in order to take more gas from Kansas and less gas from other states. The district court nevertheless held that, because the order was directed at producers of natural gas, the order was within the "producing or gathering" exemption in the Natural Gas Act. App. C, *infra*, 59a.

On appeal to the Kansas Supreme Court, the Court held that, although the order is obviously intended to regulate the affairs of the pipeline purchasers, the order is lawful because on its face it is directed to producers. The court stated:

> "Hence, the question which this court must decide is whether this indirect effort to influence purchasers meets the standards noted in *Northern Gas*, which would preclude state regulation in this area. As stated in *Northern Gas*, federal regulation does not apply to the production or gathering of natural gas. Interpreted in a narrow sense, as suggested by *Northern Gas*, the matter of allowables must be construed to pertain to production. The state has regulatory authority over production. The rules on underages are a part of production regulation and thus are not violative of the federal act, even though purchasers are indirectly caught in the backwash." App. B, *infra*, 40a-41a.

Northwest Central Pipeline Corporation and K N Energy, Inc., appealed from the decision of the Supreme Court of Kansas to this Court. On February 24, 1986, this Court vacated the judgment of the Kansas Supreme Court and remanded the case for further consideration in light of *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, 474 U.S. 409, 106 S. Ct. 709, 88 L. Ed. 2d 732 (1986). *See* Order of February 24, 1986, at ____ U.S. ____, 106 S. Ct. 1169, 89 L. Ed. 2d 289. The Court's mandate issued on March 26, 1986.

On remand, the Supreme Court of Kansas reaffirmed its earlier decision and attempted to distinguish the instant case from this Court's decision in *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board, supra*, on the theory that the challenged rule "pertains to gas producers" rather than to gas pipelines. See Appendix A, *infra*, 11a.

THE QUESTIONS ARE SUBSTANTIAL

I. DOES PARAGRAPH (p) AS AMENDED BY THE KANSAS CORPORATION COMMISSION INVADE THE EXCLUSIVE JURISDICTION OF THE FEDERAL ENERGY REGULATORY COMMISSION?

1. The conceded purpose of the challenged Kansas

order is to compel increased purchases of Kansas gas in the interstate market, with no regard for the effects this result would have on the national interest or the federal regulatory scheme. *See* App. A, *infra*, 10a-12a; App. B, *infra*, 37a-41a. Moreover, the district court specifically found, as a matter of fact, that the order would necessitate a modification of purchasing patterns by interstate pipelines. App. C, *infra*, 58a. Under the decisions of this Court, these findings require that the Commission's order be invalidated as a matter of federal law.

In *Northern Natural Gas Co. v. State Corp. Comm'n*, 372 U.S. 84 (1963), this Court held that a Kansas regulation that compelled a modification of purchasing decisions by interstate pipelines interfered with the exclusive federal authority to regulate the cost structure of interstate pipelines and was therefore invalid under the Supremacy Clause. The Court held in *Northern Natural* that no individual State could regulate or direct the purchase practices of interstate pipelines, because such authority had exclusively been made the province of federal regulation under the Natural Gas Act, 15 U.S.C. § 717, *et seq*.

In *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board (Transcontinental)*, *supra*, the court reaffirmed its holding in *Northern Natural*. In *Transcontinental* the court struck down a Mississippi regulation that "disturb[ed] the uniformity of the federal

scheme" and "threaten[ed] to distort the market * * * by artificially increasing supply and price." 88 L. Ed. 2d at 745-46. [U.S.Cite]

The Commission's order that is challenged in this case must have one of two consequences. If the Commission succeeds in its announced purpose of forcing increased production and purchases of Kansas gas by interstate pipelines, the result would be a distortion of the national natural gas market. Under the holdings of *Northern Natural* and *Transcontinental*, the order will have thus improperly intruded into an area of deep federal concern. If the order fails to stimulate production, the coercive element of the order would come into play. The permanent cancellation of allowables would cause interstate pipelines to forever lose the right to take gas that heretofore has been available from producers whose gas has been dedicated to interstate commerce. The district court determined that, as a matter of fact, the order "will cause some permanent loss of underages (allowables) due to market conditions." App. C, *infra*, 58a. This diversion of gas from the interstate market treads upon the exclusive authority of the Federal Energy Regulatory Commission to regulate the abandonment of gas dedicated to interstate commerce. *See generally United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529 (1979); *California v. Southland Royalty Co.*, 436 U.S. 519 (1978); *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137 (1960). Under either resulting scenario, the

Kansas rule will thus infringe the authority of the Federal Energy Regulatory Commission to regulate the cost-structures of interstate pipelines. *See Northern Natural Gas Co. v. State Corp. Comm'n, supra,* 372 U.S. at 92.

The broad-based implications of the Kansas Corporation Commission's order that is challenged on this appeal, and the Kansas Supreme Court decision upholding it, are readily apparent. If the Kansas order which encourages production from Kansas at the expense of other states is found constitutional, other states will surely soon follow Kansas' lead.[3] FERC authority to regulate the sale and transportation of gas in interstate markets would be circumvented by discriminatory laws or regulations enacted by the individual states for purposes of promoting the production of natural gas in the individual state, and protecting it from competitive gas sources outside the state.

Such piecemeal regulation by the states quite plainly impinges upon the exclusive authority of FERC. The need for paramount federal authority is compelling because the state agency would regulate in the state interest, rather than national interest. The unavoidable conflict between producing and consuming states makes

[3] Oklahoma has also recently attempted to assert authority to regulate interstate pipeline purchases of gas by regulating the allocation of production among various categories of wells. This state regulation was held unconstitutional as applied to interstate pipelines in *ANR Pipeline Co. v. State Corp. Comm'n,* Civ. No. 85-1929A (W.D. Okla. Sept. 2, 1986), appeal pending, No. 86-2481 (10th Cir.).

the desirability of uniform federal regulation abundantly clear. *Public Service Comm'n v. FERC,* 610 F.2d 439 (6th Cir. 1979).

2. In the proceedings below, the district court found, as a matter of fact, that the Kansas Commission's order would have two important effects on the interstate pipelines purchasing gas from the Kansas Hugoton Gas Field (App. C, *infra*, 58a (emphasis supplied)):

> "As a practical matter, the change in 'P' will cause some *permanent loss* of underages (allowables) due to market conditions and will also cause a *change in the 'mix'* of natural gas which pipelines transport for sale many miles away."

These consequences of the Kansas Commission's order place the order squarely within this Court's rulings that prohibit the states from regulating the purchase practices of interstate pipelines because such regulation invades the FERC's exclusive jurisdiction to regulate the cost structure that exists between interstate gas pipelines and interstate gas consumers. *Northern Natural Gas Co. v. State Corp. Comm'n, supra.*

The Kansas Supreme Court, however, has now twice held that the Kansas Commission's order did not interfere with FERC's exclusive authority to regulate interstate pipelines on the theory that the order applies only to "production or gathering" of natural gas (App. A, *infra*, 11a-12a; App. B, *infra*, 40a-41a). It is true that the Natural Gas Act does not confer jurisdiction to the

FERC over "the production or gathering of natural gas." 15 U.S.C. § 717(b). But, under the rulings of this Court and the record below, it is evident that the Kansas order, both in its purpose and in its actual effect, regulates pipelines and is not limited to "production and gathering" of natural gas. Indeed, the admitted purpose of the order is to compel interstate pipelines to purchase large quantities of Kansas Hugoton gas in a very short time period, or to lose forever their right to take such gas. The Kansas Commission's staff witness admitted that the order had the specific intent to change the purchasing patterns of pipelines (R. Vol. 9, at 48), and the district court specifically found that, indeed, the order quite plainly *would* have that effect. App. C, *infra*, 58a.

The Kansas Commission's order was based on the Commission's finding that: "The evidence clearly demonstrates that [the preexisting] Paragraph P does not provide operators sufficient incentive to produce gas." App. D, *infra*, 73a-74a. The evidence cited by the Commission to support this finding was the fact that actual production had fallen far behind the maximum allowable production in the Field. App. D, *infra*, 74a. It requires no sophisticated analysis, however, to understand that operators need no incentive to produce and sell gas. Any operator will sell as much as a pipeline will take. There is *no* evidence in the record to suggest that gas well operators have ever been unwilling to sell the

maximum allowable in gas production. The record is replete with evidence, however, that interstate gas pipelines have been unable to take the inflated Kansas allowables for Kansas Hugoton gas and still comply with their contractual gas purchase obligations in other states. *See, e.g.*, App. B, *infra*, 34a. Therefore the only purpose and effect of the challenged order is to compel interstate pipelines to take more gas from Kansas Hugoton Field at the expense of production in other states. The Kansas Supreme Court has expressly held that this purpose is within the Commission's power. App. A, *infra*, 11a.

The Kansas Commission's order is thus clearly not a mere "production or gathering" regulation, but is instead a regulation designed purposefully to affect the purchasing patterns of gas pipelines. The order is *not* designed to regulate the activities of producers; instead, it is designed and intended to regulate the purchasing patterns of interstate pipelines.

The Kansas Supreme Court itself recognized the implausibility of the contention that the Kansas Commission's order dealt solely with "production or gathering" of gas. The Court stated: "The order in the instant case gives us pause. *It obviously is intended for purchasers*, but is directed to producers * * *." App. B, *infra*, 40a (emphasis added). The court simply concluded, however, that "[i]nterpreted in a narrow sense, as suggested by *Northern Gas*, the matter of allowables

must be construed to pertain to production." *Id.* at 41a. But Chief Justice Schroeder, in his dissent on the initial appeal, exposed the fatal defect in the Kansas Supreme Court's analysis (*id.* at 46a):

> "Although the commission contends that its order is directed at producers not purchasers, its real purpose is to create an impact on purchasers' business decisions concerning the makeup of their interstate gas mix, with an eye toward making it economically prohibitive for such purchasers not to purchase increased substantial volumes of gas from the Kansas Hugoton Field even at the expense of their purchases from other states."

Given these facts, it is impossible to understand the reasoning behind the Kansas Supreme Court's holding that the Kansas Commission's order relates merely to "production and gathering" of gas.[4] The order is in fact a regulation of interstate pipelines that has the precise effect of altering these pipelines' cost structures that was forbidden by this Court in its decision in *Northern*

[4] The production or gathering exemption has been strictly construed by this Court. The terms "production and gathering" have been narrowly confined to the physical acts of drawing gas from the earth and preparing it for the first stages of distribution. *Northern Natural Gas Co. v. State Corp. Comm'n*, 372 U.S. 84, 90 (1963). Although FERC has no jurisdiction over drilling and spacing and the like, *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581 (1945), it does have jurisdiction over the sale of natural gas in the interstate commerce, even though such sale may occur before production and gathering is ended. *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965). Cancellation of allowables particularly where those allowables were in excess of actual requirements and the cancellation itself is specifically designed as a prod to affect pipeline purchasing practices and to require pipelines to purchase more gas from Kansas, hardly fall into the limited classification of "drilling and spacing and the like," or the "physical activities, processes and facilities of production and gathering."

Natural Gas Co. v. State Corp. Comm'n, *supra*, 372 U.S. at 91-92, and *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, *supra*, 474 U.S. at ____. The mere fact that some of the incidences of the order relate to production and gathering does not bring the order into the ambit of the exemption where the order impacts directly upon transportation and wholesales of natural gas in interstate commerce. *See id.* at 606; *Public Service Comm'n v. FERC*, 610 F.2d 439-44 (6th Cir. 1979).[5]

3. Once it is determined that the Kansas Commission's order does not fall within the "producing or gathering" exception to the Natural Gas Act, the conclusion is inescapable that the order invades the FERC's exclusive jurisdiction "to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers." *Northern Natural*

[5] In *Northern Natural* and *Transcontinental* the court has nullified state regulations that had the effect of distorting the natural gas market by inducing pipelines to increase their takes from a particular state. In both of these cases the individual states were trying to serve a parochial "conservation" purpose, but the court could not tolerate the method chosen to accomplish the goal of conservation. A distinction must be made between state regulations that restrict production of gas to avoid physical waste, or restrict production of gas to protect correlative rights, and those that require increased production to protect correlative rights. In *Champlin Refining Co. v. State Corp. Comm'n*, 286 U.S. 210 (1932), the court upheld restrictive proration rules in the face of constitutional challenges. *See also Thompson v. Consolidated Gas Utils. Corp.*, 300 U.S. 55 (1937). In *Northern Natural* and *Transcontinental*, however, the court invalidated ratable taking rules, in large part because the effect of the rules would have been to *increase* production from the respective state promulgating the rule, at the expense of production from other sources of supply. The instant order suffers from the same infirmity that militated the demise of the ratable taking rules.

Gas Co. v. State Corp. Comm'n, supra, 372 U.S. at 92.

Both the district court and the Kansas Supreme Court recognized that the Kansas Commission's order would cause a substantial readjustment of purchasing patterns among interstate pipelines. App. B, *infra*, 39a; App. C, *infra*, 58a. This type of state regulation is precisely the kind of regulation this Court held impermissible in *Northern Natural*. Natural gas must be sold contemporaneously with its delivery to a pipeline because it cannot be stored in tanks. Accordingly, gas cannot be purchased in excess of the gas market demand. Increased takes from the Kansas Hugoton Gas Field therefore necessarily cause decreased takes from other gas fields. Such decreased takes from other more recently developed natural gas fields, most of which are in states other than Kansas, may impose significant contractual take-or-pay liabilities against the interstate pipelines.[6] In addition, the rapid depletion of older, low-cost Hugoton gas will result in less Hugoton gas being available in the future, potentially causing sharp increases in gas costs in future decades.

By attempting to dictate the source of gas to be pur-

[6] Gas sale contracts often provide that the pipeline will either take or pay for a certain minimum quantity of gas each year or, if that minimum quantity is not taken, will nonetheless pay *as if* the gas had been taken. Such contract clauses are referred to as "take-or-pay" clauses. Requiring a pipeline to increase its purchases ("takes") in one state therefore may well lead to increased "take-or-pay" liability when purchases are necessarily reduced in other states.

chased by interstate pipelines, the Kansas Commission's order impairs the FERC's undisputed exclusive authority over the purchasing practices of interstate pipelines. As this Court held when Kansas previously sought to direct the purchasing decisions of interstate pipelines, "The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, *or for state regulations which would indirectly achieve the same result* * * *." *Northern Natural Gas Co. v. State Corp. Comm'n, supra,* 372 U.S. at 91 (citations omitted, emphasis supplied).[7]

4. Under existing circumstances, the Kansas Commission's order will also cause the permanent loss by some interstate pipelines of their rights to purchase significant quantities of gas that have been dedicated to interstate commerce and that the FERC has not authorized to be abandoned under the Natural Gas Act. *See* note 2, *supra*. This aspect of the order strikes at the heart of the FERC's exclusive authority under Section 7(b) of the Natural Gas Act, 15 U.S.C. § 717f(b). This Section provides that gas dedicated to interstate commerce by interstate pipelines may not be withdrawn

[7] *See also* Brief for the United States and the Federal Energy Regulatory Commission in *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, No. 84-1076, *prob. juris. noted*, 85 L. Ed. 2d 140 (March 25, 1985), which notes (at p. 22) that a state rule that seeks to regulate or affect the purchasing practices and decisions of interstate pipelines is invalid because it "frustrates the ability of pipelines to minimize gas costs and limits the Commission's authority to monitor pipeline purchasing practices * * *."

from interstate movement without FERC approval. *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137 (1960); *California v. Southland Royalty Co.*, 436 U.S. 519 (1978).

The Kansas Supreme Court recognized that interstate pipelines like Northwest Central will be physically unable to take sufficient quantities of gas to prevent cancellations of some underages with a resulting effect on dedicated reserves. The court noted that "History indicates market changes sufficient to make up underages have taken six to ten years." App. A, *infra*, 19a. Yet, the Kansas Commission's order mandates that a well must be in an overp[illegible]ced status before any cancelled underage may be reinstated, and further exacerbates this problem by requiring any reinstated underage to be produced within five years. App. D, *infra*, 79a-80a.

There is thus an "imminent possibility of collision" between the Kansas Commission's order and the federal scheme of regulation. *Northern Natural Gas Co. v. State Corp. Comm'n, supra*, 372 U.S. at 92. For this additional reason, the Kansas order is invalid under the Supremacy Clause.

II. DOES PARAGRAPH (p) AS AMENDED BY THE KANSAS CORPORATION COMMISSION CONSTITUTE AN IMPERMISSIBLE BURDEN ON INTERSTATE COMMERCE?

Aside from preemption concerns, the Kansas Commission's order impermissibly burdens interstate commerce since its purpose is to secure a larger share of the interstate gas market for gas produced from the Kansas Hugoton Gas Field at the expense of out-of-state producers. This sort of economic protectionism is flatly prohibited by the Commerce Clause.

1. This Court held in *Pennsylvania v. West Virginia*, 262 U.S. 553 (1923), that a state law that obstructs or burdens transmission of natural gas from one state to another is a prohibited interference with interstate commerce. The Kansas Commission's order is specifically designed to obstruct interstate commerce by compelling interstate pipelines to adjust their customary purchasing patterns to buy more Kansas Hugoton gas, at the peril of losing their dedicated gas reserves to the intrastate markets which, on balance, have already achieved an overproduction of Kansas Hugoton gas. App. B, *infra*, 46a. A state may not legitimately seek to protect its citizens by placing itself in a position of economic superiority, ignoring problems common to all and forcing others to bear the burden of its regulations. *Philadelphia v. New Jersey*, 437 U.S. 617 (1978).

2. The Kansas Commission's order fails to satisfy the constitutional test articulated in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970):

> "Where the Statute regulates evenhandedly to effectuate a legitimate local public interest, and its

effects on interstate commerce are only incidental, it will be upheld * * *."

397 U.S. at 142.

First, the Kansas Commission's order does not regulate evenhandedly. The evidence showed that the intrastate pipelines in the Kansas Hugoton Gas Field had, on balance, achieved current overproduction at the time the order was entered, whereas the interstate pipelines had huge deficiencies to make up before they could even begin to take cancelled underages. As the dissenting opinion pointed out below, the effect of the order as promulgated would be "to cement for all time that discrimination * * *. [Kansas Power and Light Company's] intrastate customers will benefit, and Northwest Central['s] interstate customers will be prejudiced." App. B, *infra*, 50a.

Second, the Kansas Commission's order does not seek to serve a legitimate local interest.[8] The effect of the order will be to withdraw a large volume of low-cost

[8]The amended regulation in fact interferes with the traditional state objective of assuring a fair allocation of production to each interest owner in the Field. The Supreme Court of Kansas, after reciting in great detail the lack of equity that will result in the Field, noted "After careful consideration, we are led to the conclusion the KCC's new definition of correlative rights is incorrect. It ignores both K.S.A. 55-703 and K.A.R. 82-3-101(15). There the emphasis is on preventing the inequitable and unjust taking of natural gas from a common source of supply with the objective of providing a way for each developed lease to ultimately produce the gas underlying it. The statutory reference to 'currently produce' must be interpreted with the rest of the sentence. It is then apparent the legislature ordered current production to be proportionate with other leases in the pool, without drainage, to attain equity." App. B, *infra*, 25a-26a.

natural gas from the established stream of interstate commerce to benefit preferentially the customers of the local intrastate gas companies. App. B, *infra*, 35a-37a. The cancellation of the right to take Kansas Hugoton gas for delivery to interstate customers is as pernicious as the prohibited attempt in *Pennsylvania v. West Virginia*, 262 U.S. 553 (1923), to force interstate pipelines to siphon gas directly to local customers.

Third, the Kansas Commission's order will have a profound effect on interstate commerce. The Kansas Corporation Commission itself admits that its orders will affect all facets of the market, including interstate commerce. App. A, *infra*, 10a. The courts below recognized that the effect of the order would be to disrupt interstate purchasing practices by increasing the proportion of gas purchased by interstate pipelines from Kansas Hugoton. App. B, *infra*, 39a; App. C, *infra*, 58a. Pipelines will also be faced with the Hobson's choice of losing the right to purchase gas in Kansas, or of paying for gas not taken pursuant to gas purchase contracts entered into by pipelines in other states for newer reserves during the peak of market demand.

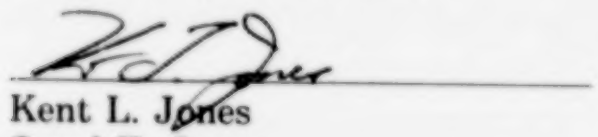
In sum, the attempt by Kansas to alter the interstate gas market to favor its own gas production and consumers at the expense of other states, interstate pipelines and interstate gas consumers violates the Commerce Clause of the United States Constitution and

threatens to disrupt the national gas market by encouraging other states to retaliate, to the ultimate detriment of the national interest.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted,



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I hereby certify that three copies of the foregoing Jurisdictional Statement were mailed, postage prepaid, this _____ day of May, 1987, addressed to the following:

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APPENDIX

APPENDIX A

No. 56,917

NORTHWEST CENTRAL PIPELINE CORPORATION;
NORTHERN NATURAL GAS COMPANY;
COLORADO INTERSTATE GAS COMPANY;
AMOCO PRODUCTION COMPANY;
and K N ENERGY, INC.;
Appellants,

v.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS;
MICHAEL LENNEN, Chairman;
RICHARD C. (PETE) LOUX, Commissioner;
PHILLIP R. DICK, Commissioner;
and their respective successors in office;
Appellees.

SYLLABUS BY THE COURT

1. In determining whether a state corporation commission's order improperly interferes with federal regulation of natural gas in interstate commerce, a two-part test is employed: (1) Whether the order falls within the comprehensive federal regulatory scheme rather than within the category of regulatory questions reserved for the states; and (2) whether the effect of the order will be to impair interstate market forces.

2. The Kansas Corporation Commission has the responsibility to prevent waste and to protect correlative rights of producers and landowners when production is from a common source of supply.

3. The Kansas Corporation Commission order amending paragraph (p) of the basic proration order for

the Kansas Hugoton Gas Field is reexamined in light of *Transcontinental Pipe Line v. Oil & Gas Bd.*, 474 U.S. ____, 88 L. Ed. 2d 732, 106 S. Ct. 709 (1986), and it is held the amendment is primarily directed at the production of gas rather than the marketing thereof and is necessary for the prevention of waste and the protection of correlative rights. Further, any effect upon interstate sales of gas is incidental rather than the objective of the order. Accordingly, the order does not transgress federal regulation of natural gas in interstate commerce.

Appeal from Gray district court, DON C. SMITH, judge. Opinion on remand filed February 20, 1987. (For original opinion affirming see 237 Kan. 248, 699 P.2d 1002 [1985], vacated and remanded, ____ U.S. ____, 89 L. Ed. 2d 289, 106 S. Ct. 1169 [1986]. Affirmed.

Mark H. Adams, II, of Adams & McCarthy, of Wichita, argued the cause, and Kent L. Jones and Orval E. Jones, of Hall, Estill, Hardwick, Gable, Collingsworth & Nelson, Inc., of Tulsa, Oklahoma, were with him on the briefs for appellant Northwest Central Pipeline Corporation.

Ralph R. Brock, of Morris, Laing, Evans, Brock & Kennedy, Chartered, of Wichita, argued the cause and was on the brief for appellants Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation, and Kansas Petroleum, Incorporated.

Timothy E. McKee, of Triplett, Woolf & Garretson, of Wichita, argued the cause, and Eugenia K. Helm and Eric Brown, of Colorado Springs, Colorado, were with him on the briefs for appellant Colorado Interstate Gas Company.

Lee Thompson, of Martin, Pringle, Oliver, Wallace & Swartz, of Wichita, argued the cause and was on the brief for appellant K N Energy, Incorporated.

Brian J. Moline, general counsel, argued the cause and James E. Browne, assistant general counsel, was with him on the brief for appellees.

The opinion of the court was delivered by

HERD, J.: This case was originally before the Court in *Northwest Cent. Pipeline Corp. v. Kansas Corp. Comm'n*, 237 Kan. 248, 699 P.2d 1002 (1985). There, we upheld the district court's order affirming a Kansas Corporation Commission (KCC or Commission) order which amended paragraph (p) of the basic proration order for the Kansas Hugoton Gas Field. The appellants sought review of our decision in the United States Supreme court, which remanded the case to this Court with directions to reconsider our decision in light of a recent Supreme Court decision, *Transcontinental Pipe Line v. Oil & Gas Bd.*, 474 U.S. ____, 88 L. Ed. 2d 732, 106 S. Ct. 709 (1986) (*Transco*).

The facts were set out in some detail in our previous decision and need not be fully repeated here. However, we briefly summarize them for convenient reference.

K.S.A. 55-701 *et seq.* provides the KCC with authority to regulate the taking of natural gas from common sources of supply within the state in order to prevent the inequities or unfair taking of natural gas from a common source of supply. Acting pursuant to this authority, on March 21, 1944, the Commission adopted the basic proration order for the Hugoton Field. The order provides limits or "allowables" for production for each well in the field. The allowables are assigned pursuant to a deliverability formula which balances various factors in an effort to regulate production to make the amount produced over time from any well equal to the amount of gas originally underlying the developed lease.

If a well produces less than its allowable, it accrues an "underage," the difference between its allowable and actual production. When a well is underproduced in relation to its allowable, its pressure rises and gas "drains" to the lower pressure areas of overproduced wells. When the larger allowable and underage is later produced, the well's pressure drops and compensating drainage occurs. After the pressure drops, the adjusted deliverability is decreased, keeping the wells in balance in the "long pull." 237 Kan. at 250-51.

Prior to 1983, cancelled underage could accumulate indefinitely without an adverse regulatory effect. Because of these conditions, purchasers were using the Kansas portion of the Hugoton Field for "storage" and purchasing additional reserves elsewhere for immediate use. This forced the Kansas Hugoton Field production below good recovery practices and upset the dynamics of the Hugoton Field, affecting both proration and correlative rights.

Accordingly, in February of 1983, the KCC amended the basic proration order to provide that underages would be permanently cancelled if the producer did not reinstate them within a certain period of time or, if reinstated, the underage was not produced within five years.

Although numerous issues were raised in the initial appeal, the primary issue for our reconsideration upon remand is whether the Commission's order improperly interferes with federal regulation of natural gas in interstate commerce. We originally resolved this issue by holding that federal regulation does not apply to the production or gathering of natural gas, citing *Northern Natural Gas Co. v. Kansas Comm'n.*, 372 U.S. 84, 9 L. Ed. 2d 601, 83 S. Ct. 646 (1963) (*Northern Gas*). We reasoned that rules on underages are part of production

regulation and thus do not violate federal regulations. 237 Kan. at 267.

Before considering whether the United States Supreme Court's decision in *Transco* requires us to change our original conclusions, let us examine the facts and holdings in both the *Northern Gas* and *Transco* cases.

Northern Gas

In *Northern Gas*, the United States Supreme Court set aside an order of the Kansas Corporation Commission requiring interstate gas pipelines purchasing gas from the Hugoton Field to take gas ratably from the wells to which they were connected.

The principal argument made by the Commission in *Northern Gas* was that the ratable take order, essential for the conservation of natural gas and conservation, is traditionally a function of state government.

The Supreme Court recognized that a significant distinction exists between conservation measures aimed directly at interstate purchasers and wholesales for resale, and those aimed at producers and production. The Court held that measures aimed at *purchasers* cannot be sustained when they threaten "the achievement of the comprehensive scheme of federal regulation." 372 U.S. at 94.

The "comprehensive scheme of federal regulation" referred to by the Court was the Natural Gas Act (NGA), 15 U.S.C. § 717 *et seq.* (1982). In discussing this act, the Court held:

> "The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas (citation omitted) or for state regulations which would *indirectly achieve* the same result." 372 U.S. at 91 (Emphasis added.).

The Court then concluded that the ratable take orders at issue in this case

> "necessarily deal with matters which directly affect the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act." 372 U.S. at 91-92.

Transco

Fifteen years after the Supreme Court decided *Northern Gas*, Congress enacted the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3301 *et seq.* (1982), which vested regulatory power in the states over the wellhead sale of gas. One question before the Supreme Court in *Transcontinental Pipe Line v. Oil & Gas Bd.*, 474 U.S. ____, 88 L. Ed. 2d 732, was whether the NGPA effectively overruled *Northern Gas*.

The Mississippi regulation at issue in *Transco* required gas purchasers to purchase gas ratably without discrimination in favor of one producer against another in the same source of supply. Transco, an interstate pipeline company, appealed the State Oil and Gas Board (Board) ruling enforcing the regulation. The Circuit Court of Mississippi and the Mississippi Supreme Court affirmed, holding that the NGPA removed from the Federal Energy Regulatory Commission (FERC) the authority conferred on it by the NGA to regulate the sale and transportation in interstate commerce of "high cost" gas. The Mississippi court thus held that the NGPA effectively overruled *Northern Gas*.

On appeal, the United States Supreme Court reversed and held the Board's order was preempted by the NGA and the NGPA.

In so holding, the Court first reviewed *Northern*

Gas and noted the Court's finding of preemption in that case rested upon two considerations:

> "First, Congress had created a comprehensive regulatory scheme, and ratable-take orders fall within the limits of that scheme rather than within the category of regulatory questions reserved for the States. Second, in the absence of ratable-take requirements, purchasers would choose a different, and presumably less costly, purchasing pattern. By requiring pipelines to follow the more costly pattern, Kansas' order *conflicted* with the federal interest in protecting consumers by ensuring low prices." 88 L. Ed. 2d at 743.

Thus, under this two-part test, the Court first had to determine whether the Mississippi Board's actions fell within a "comprehensive regulatory scheme." This determination required an examination of the NGPA. The Court considered the history of the NGPA and held its enactment reflected a congressional belief that a new system of natural gas pricing was needed to balance supply and demand. However, the Court concluded the NGPA did not "constitute a federal retreat from a comprehensive gas policy." 88 L. Ed. 2d at 743. The Court reached this conclusion despite the fact that the NGPA specifically states that the provisions of the NGA and the jurisdiction of the FERC shall not apply to the "first sale" of high cost gas or new natural gas.

The Court reasoned that the fact the FERC can no longer directly regulate the prices at which pipelines purchase high cost gas has little to do with whether state regulations which affect a pipeline's cost and purchasing patterns impermissibly intrude upon federal concerns. The Court further reasoned that the inability of the FERC under the NGPA to regulate some aspects of wellhead sales of gas is a result of Congress' intent

that the determination of supply and first-sale price be left to the market. Finally, the Court concluded that while Congress enacted the NGPA in an attempt to move toward a less regulated national natural gas market, its decision to remove jurisdiction from the FERC cannot be interpreted as an invitation to the states to impose additional regulations. 88 L. Ed. 2d at 744.

The court next determined the Mississippi Board's order disturbed the "uniformity of the federal scheme," 88 L. Ed. 2d at 745, because it would have the effect of increasing the ultimate price of gas to consumers. The Court reasoned that since "take-or-pay" provisions are standard industry-wide and pipelines are already committed to purchase gas in excess of market demand, Mississippi's order would require Transco to take delivery of non-contract gas. This in turn would result in Transco not taking delivery of contract gas elsewhere, triggering take-or-pay provisions and ultimately increasing costs to Transco customers. 88 L. Ed. 2d at 745.

The Commission now urges this court to apply the same analysis used in *Transco*, but to reach a different result than did the Supreme Court — *i.e.*, that the order amending the basic proration order for the Hugoton Field is not preempted by the NGA or the NGPA. In contrast, the appellants argue that *Transco* requires us to reverse our previous ruling upholding the Commission's order.

In determining whether *Transco* necessitates a reversal of our previous holding, we should apply the two-part test employed by the Supreme Court in both *Northern Gas* and *Transco*. First, we must consider whether the order amending the basic proration order for the Hugoton Field falls within the limits of a comprehensive federal regulatory scheme rather than within

the category of regulatory questions reserved for the states; and, if so, whether the effect of the order will be to impair market forces.

The Commission argues the order in question here does not come within a comprehensive federal regulatory scheme because it is directed at producers of natural gas rather than purchasers. The Commission points out that Congress has specifically excluded the areas of "production and gathering" from the FERC's jurisdiction under the Natural Gas Act. 15 U.S.C. § 717(b). "Production" and "gathering" are terms which have been narrowly defined to include the physical acts of drawing gas from the earth and preparing it for the first stages of distribution. *Northern Gas Co. v. Kansas Comm'n.*, 372 U.S. at 90. This distinction was also recognized in *Transco* where the Court noted that it is " 'undeniable that a state may adopt reasonable regulations to prevent economic and physical waste of natural gas.' " 88 L. Ed. 2d at 742 (quoting *Cities Service Co. v. Peerless Co.*, 340 U.S. 179, 95 L. Ed. 190, 71 S. Ct. 215 [1950]).

The Commission further argues that the issue of federal preemption was adequately dealt within in our first opinion on this case where we determined that the Commission's order was not preempted by federal regulation. We held:

> "The order in the instant case gives us pause. It obviously is intended for purchasers, but is directed to producers. Hence, the question which this court must decide is whether this indirect effort to influence purchasers meets the standards noted in *Northern Gas*, which would preclude state regulation in this area. As stated in *Northern Gas*, federal regulation does not apply to the production or gathering of natural gas. Interpreted in a narrow

sense, as suggested by *Northern Gas*, the matter of allowables must be construed to pertain to production. The state has regulatory authority over production. The rules on underages are a part of production regulation and thus are not violative of the federal act, even though purchasers are indirectly caught in the backwash." 237 Kan. at 266-67.

The appellants concede that the NGA does not confer jurisdiction to the FERC over the production or gathering of natural gas, but argue the Commission's order, both in *purpose* and *effect*, is not so limited. As support for this argument, the appellants point out that the admitted purpose of the order is to compel interstate pipelines to purchase a greater volume of gas from the Hugoton Field. The Commission argues its purpose was to prevent waste and protect correlative rights.

The appellants also refer to the Supreme Court's statement in *Transco* that "[the Mississippi order] disturbs the uniformity of the federal scheme, since interstate pipelines will be forced to comply with varied state regulations of their purchasing practices." 88 L. Ed. 2d at 745. Appellants contend that if another state were to promulgate a similar order to "encourage production," the appellants would be forced to comply with numerous state regulations regarding purchasing practices, thus "disturbing the uniformity of the federal scheme."

The Commission does not dispute that its order will have an impact upon "*all facets* of the market including interstate commerce." However, it contends any such effect will be the result of decisions by the pipeline purchasers, not the gas producers to whom the order is addressed.

We have reexamined our decision in light of *Transco*, as suggested by the U.S. Supreme Court.

From that reexamination, we conclude this case is distinguishable from *Transco*. There, the state regulation is addressed to gas purchasers. Here, the amendment to paragraph (p) of the basic proration order for the Kansas Hugoton Gas Field pertains to gas producers. Congress specifically excluded production and gathering of gas from the FERC's jurisdiction under the Natural Gas Act. 15 U.S.C. § 717(b). Further, the Commission is vested with the responsibility to prevent waste and protect correlative rights of producers and landowners when production is from a common source of supply. *Northwest Cent. Pipeline Corp. v. Kansas Corp. Comm'n*, 237 Kan. at 254; *Kansas-Nebraska Natural Gas Co. v. State Corporation Commission*, 169 Kan. 722, Syl. ¶ 5, 222 P.2d 704 (1950). The Commission has exercised its authority in this case by limiting the time in which producers may reinstate underages. Placing such a limitation on recovery of underages is a part of the Commission's authority to prorate and control production to prevent economic and physical waste and to protect correlative rights between producers in the Kansas Hugoton Gas Field and those in the Oklahoma and Texas Hugoton Field.

It is obviously correct that any change in rates of production of gas sold in interstate commerce has an effect on the interstate market. But that alone does not eliminate the jurisdiction of the Kansas Corporation Commission. If so, the FERC would have total jurisdiction over all gathering and production of gas which is sold in interstate commerce.

We think the test of whether the FERC has jurisdiction over state regulation of producers is whether the regulation is primarily directed at the marketing of gas rather than production thereoef. Here, the Commission found the amendment to paragraph (p) of the basic proration order was necessary for the prevention

of waste and protection of correlative rights. Though controverted, there is evidence in the record to support that finding. Further, any effect on the interstate sale of gas is merely incidental rather than the objective of the order. Thus, we hold the order does not transgress federal regulation of natural gas in interstate commerce.

The order is affirmed.

Schroeder, C. J., dissenting.

Allegrucci, J., not participating.

APPENDIX B

No. 56,917

NORTHWEST CENTRAL PIPELINE CORPORATION;
KN ENERGY, INC.;
AMOCO PRODUCTION COMPANY; and
COLORADO INTERSTATE GAS COMPANY,
Appellants,

v.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS,
MICHAEL LENNEN, Chairman,
RICHARD D. (Pete) LOUX, Commissioner,
PHILLIP R. DICK, Commissioner,
and their respective successors in office,
Appellees.

SYLLABUS BY THE COURT

1.

K.S.A. 66-118d limits judicial review of an order of the Kansas Corporation Commission (KCC) to determine whether the order is lawful or reasonable. A court has no power to set aside such an order unless it finds that the KCC acted unlawfully or unreasonably. An order is lawful if it is within the statutory authority of the commission and if the prescribed statutory and procedural rules are followed in making the order. An order is generally considered reasonable if it is based on substantial competent evidence. The legislature has vested the commission with wide discretion, and its findings have a presumption of validity on review. Discretionary authority has been delegated to the commission, not to the courts; the power of review does not give the courts authority to substitute their judgment for that

of the commission. The commission is aided by a staff of assistants with experience as statisticians, accountants and engineers, while courts have no comparable facilities for making the necessary determinations.

2.

The KCC is vested with the responsibility to prevent waste and to protect correlative rights of producers and landowners when production is from a common source of supply.

3.

The KCC's authority is limited to that conferred by statute.

4.

An order of the KCC will be set aside as arbitrary, capricious and unreasonable if it is not based upon substantial competent evidence.

5.

Where a regulatory body has authority to change positions on an issue if the new position is supported by substantial competent evidence, parties may not reasonably rely on any prior order of the body to such an extent to invoke the doctrine of equitable estoppel.

6.

It is within the discretionary authority of the commission to accept or reject any expert testimony presented. The facts to be considered and the weight to be accorded them are matters left to KCC discretion.

7.

Selling gas is not a function of the KCC, nor is the providing of incentives for additional production, but when additional production is needed to protect correlative rights and to prevent waste, the commission has authority to create such incentives.

8.

Federal regulation does not apply to production or gathering of natural gas. Thus, State control over allowables, which pertain to production, does not improperly infringe on federal regulation of natural gas in interstate commerce.

9.

Appeals under K.S.A. 55-606 go directly to the state Supreme Court, despite the provisions of K.S.A 1984 Supp. 60-2101.

10.

The right to an appeal is neither vested nor a constitutional right, but is strictly statutory in nature.

Appeal from Gray district court, DON C. SMITH, judge. Opinion filed May 10, 1985. Affirmed.

Mark H. Adams, II, of Adams, Jones, Robinson & Malone, of Wichita, argued the cause, and *Teresa J. James*, of the same firm, and *Bill Sears* and *John H. Cary*, of Tulsa, Oklahoma, were with him on the briefs for appellant Northwest Central Pipeline Corporation.

Ralph R. Brock, of Morris, Laing, Evans, Brock & Kennedy, Chartered, of Wichita, argued the cause, and *Robert W. Coykendall*, of the same firm, was with him on the brief for appellants Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation, and Kansas Petroleum, Inc.

Timothy E. McKee, of Martin, Pringle, Oliver, Triplett & Wallace, of Wichita, argued the cause, and *William M. Lange* and *Kim R. Cocklin*, of Colorado Springs, Colorado, and *Robert A. Miller, Jr.*, of Lakewood, Colorado, were with him on the brief for appellants Colorado Interstate Gas Company and KN Energy, Inc.

Glenn D. Young, Jr., of Gott, Young & Bogle, P.A., of Wichita, argued the cause, and *Victor S. Nelson*, of

the same firm, was with him on the brief for appellant Amoco Production Company.

Charles H. Apt III, of Glaves, Weil, Evans & Hoke, of Wichita, argued the cause, and *Jack Glaves*, of the same firm, and *William Robertson*, of Kansas City, Missouri, were with him on the brief for appellee Panhandle Eastern Pipe Line Company.

Jeff Kennedy, assistant general counsel, argued the cause, and *Brian J. Moline*, general counsel, was with him on the brief for appellee Kansas Corporation Commission.

Richard C. Byrd, of Anderson, Byrd & Richeson, of Ottawa, argued the cause, and *Steven C. James*, of Amarillo, Texas, was with him on the brief for intervenor-appellee Mesa Petroleum Company.

The opinion of the court was delivered by

HERD, J.: This is an appeal from an order affirming a Kansas Corporation Commission (KCC) order amending paragraph (p) of the basic proration order of the Kansas Hugoton Gas Field.

Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation, and Kansas Petroleum Inc., are independent producers of natural gas from the Kansas Hugoton Field and operate a total of 189 wells connected to various pipeline systems in the field. Colorado Interstate Gas Company and KN Energy, Inc. (KN) are interstate pipeline companies engaged in the transportation and sale for resale of natural gas in interstate commerce. KN is also engaged in the production of natural gas from the Hugoton Field and operates numerous wells which produce gas from that field. Northwest Central Pipeline Corporation (successor to Cities Service) is a pipeline company also operating in the Hugoton Field. Amoco Production

Company is also a lessee-producer of natural gas in the Hugoton Field. Each of these companies appeared before the KCC to contest the amendment to the basic order, and are appellants here. Panhandle Eastern Pipe Line Co. is an interstate pipeline which purchases gas from Hugoton wells. Panhandle participated in the hearings before the KCC and supported the KCC's position. Panhandle intervened in the appeal before the district court. Mesa Petroleum Company is a producer in the Hugoton Field. Mesa was a party to the proceedings before the KCC and supports the amended order.

The Kansas Hugoton Field is approximately one hundred sixty miles long and forty to seventy-two miles wide. It covers all or major portions of nine Kansas counties and minor portions of two additional counties. The over 4,000 gas wells in the field are connected to pipeline systems of seven major producers and several smaller purchasers.

The basic proration order for the Hugoton Field was adopted on March 21, 1944. The purpose of the order is to prorate the demand for gas, as determined twice a year by the commission, among all the wells in the Hugoton Field. The proration is made by assigning an allowable to each well. From its inception the basic proration order has assigned the allowables on the basis of the relative abilities of the wells to produce gas pursuant to a deliverability formula. The formula balances various factors in an effort to regulate production so that the amount produced over time from any well is equal to the amount of gas originally in the developed lease.

Some adjustments in allowables resulting from the deliverability formula are caused by pressure differentials in the various gas wells. Gas flows from high pressure areas to low pressure areas. A well's pressure

falls when it is produced. When a well is underproduced in relation to its allowable, and relative to the other wells which are producing their allowables, its pressure becomes higher. If this condition is permitted to continue over a period of time, drainage occurs from the underproduced well with the higher pressure to the low pressure area of the overproduced wells. As pressure is a major component in determining adjusted deliverability, the pressure differences result in a higher adjusted deliverability for the underproduced wells with a resulting increase in the current allowable. When the larger allowable and underage is produced, the well's pressure drops below the other wells and compensating drainage occurs. After the pressure drop the adjusted deliverability for the well is decreased with a resulting decrease in its allowable. This is the technique utilized in the attempt to keep the wells in balance in the long pull.

Divergent rates of "takes," as a result of varying market conditions experienced by the purchasers in the field, cause unplanned pressure differences among the producing wells. Every purchaser, because of varying market demands, has gone through cyclical periods of overproduction followed by periods of underproduction causing underages. The different purchasers are not in the same phase of the cycle at the same time. As a result, drainage among the developed leases is constantly taking place. Prior commission practice developed a system designed to ensure that counter or compensating drainage would occur.

The history of the field shows the turnaround in the marketing conditions of the various purchasers from periods of low demand to periods of high demand often takes many years. For example, Amoco's wells, 97% of which are connected to Northwest Central Pipeline, were underproduced in the late 1960's and early 1970's and

suffered great volumes of cancelled underage. From May, 1972, through 1981, 66,707,113 million cubic feet (MCF) of cancelled underage were reinstated, of which 60,650,544 MCF were produced. Now, however, due to high allowables assigned by the commission and soft market demand, these wells have suffered approximately 73.7 billion cubic feet (BCF) of cancelled underage and the volumes of cancellation are increasing monthly. Cabot, whose wells are also connected to Northwest Central, experienced this same cycle. Cabot suffered essentially no cancelled underage prior to 1967, but during the next six-years had 1,390,905 MCF cancelled, followed by a six-year period in which 1,158,808 MCF were reinstated, of which approximately 87% was produced. During the last three-and-a-half years Cabot again has suffered large volumes of cancelled underage. KN Energy was overproduced in the late 1960's and early 1970's, but became underproduced from approximately 1971 through 1977. It has been making up underage since 1978. It predicts it will take nine years to make up all of its underage. The Mesa wells, which are now 2.6 BCF overproduced, were underproduced in 1953 and incurred cancellations of underage with no reinstatement until 1964.

As of September 1, 1982, the entire Kansas Hugoton Field had an underage of 204.5 BCF as compared to 144.5 BCF underage September 1, 1981. According to KCC records, there have been 508 BCF of underages cancelled in the Kansas Hugoton Field from January 1, 1967 to August 1, 1982. 194 BCF of those underages were reinstated. It is significant to note that all appellants here are in an underproduced status currently, while Mesa and Panhandle are both in an overproduced status. History indicates market changes sufficient to make up underages have taken six to ten years.

Since it was first issued, various provisions of the basic order, including paragraph (p), have been amended, whenever the KCC determined any such provision was not adequately achieving the purpose of the order.

Because of the volume of underproduction, in March, 1982, the KCC began a general investigation into the provisions of the basic proration order to determine whether there was a need for revision. Hearings were held where it was determined some producers had accumulated excessively high underage in the Hugoton Field. As a result of the hearings, the commission issued its order on February 16, 1983, which amended paragraph (p) of the basic order for the avowed purpose of reducing underages.

Prior to this amendment to paragraph (p), the order permitted any well with an adjusted deliverability in excess of 300 MCF to accumulate underproduction equal to six times the amount of the current allowable assigned to the well for the preceding January. Any amount in excess of this formula was cancelled. The cancelled underage would then be reinstated if the producer could show the well was in an overproduced status and that purchasers were willing and able to take the gas within a reasonable time.

The amendments to paragraph (p) in dispute here divide the cancelled underage in the field into three categories: (1) underage cancelled prior to January 1, 1975; (2) underage cancelled between January 1, 1975, and December 31, 1982; and (3) underage cancelled after December 31, 1982. For each of these categories of underage the commission established requirements to be met by producers seeking to have such underage reinstated. For the pre-1975 cancelled underage, a producer was required to make application for reinstatement with the commission on or before December 31,

1983. For 1975 to 1982 cancelled underage, reinstatement must be requested by December 31, 1985. For underage cancelled after December 31, 1982, the producer has three years from the date of cancellation to apply for reinstatement. For any producer to request reinstatement of underage cancelled after 1974, the affected well must be in an overproduced status. Any underage not reinstated, or if reinstated not produced at the end of the allotted time period, will be cancelled permanently. A producer has sixty months in which to produce the reinstated underage.

After rehearing by the KCC in which the commission's order was affirmed, the case was appealed to the district court. The district court affirmed the commission's order.

Prior to separate discussion of the issues it is important to remember the scope of appellate review of KCC orders. We recently set out the rules in *Oilfield Fluid Motor Carriers v. Kansas Corporation Comm'n.*, 234 Kan. 983, 677 P.2d 982 (1984), where we stated:

> " 'K.S.A. 1978 Supp. 66-118d limits judicial review of an order by the commission to determining whether the order is "lawful" or "reasonable." *Kansas Gas & Electric Co. v. State Corporation Commission*, 218 Kan. 670, Syl. ¶1, 544 P.2d 1396 (1976). A court has no power to set aside such an order unles it finds that the commission acted unlawfully or unreasonably. *Jones v. Kansas Gas and Electric Co.*, 222 Kan. 390, 396-7, 565 P.2d 597 (1977). An order is "lawful" if it is within the statutory authority of the commission, and if the prescribed statutory and procedural rules are followed in making the order. *Central Kansas Power Co. v. State Corporation Commission*, 221 Kan. 505, Syl. ¶1, 561 P.2d 779 (1977). An order is generally considered

"reasonable" if it is based on substantial competent evidence. *Jones v. Kansas Gas and Electric Co.*, 222 Kan. 390, Syl. ¶2.

" 'The legislature has vested the commission with wide discretion and its findings have a presumption of validity on review. *Central Kansas Power Co. v. State Corporation Commission*, 221 Kan. at 511. Since discretionary authority has been delegated to the commission, not to the courts, the power of review does not give the courts authority to substitute their judgment for that of the commission. *Central Kansas Power Co. v. State Corporation Commission*, 206 Kan. 670, 675, 482 P.2d 1 (1971). The commission's decisions involve the difficult problems of policy, accounting, economics and other special knowledge that go into fixing utility rates. It is aided by a staff of assistants with experience as statisticians, accountants and engineers, while courts have no comparable facilities for making the necessary determinations. *Southwestern Bell Tel. Co. v. State Corporation Commission*, 192 Kan. 39, 48-9, 386 P.2d 515 (1963).' " 234 Kan. at 986, quoting *Midwest Gas Users Ass'n. v. Kansas Corporation Commission*, 3 Kan. App. 2d 376, 595 P.2d 735, *rev denied* 226 Kan. 792 (1979).

The first issue raised in this appeal is whether the order of the KCC is in violation of K.S.A. 55-703.

The KCC is vested with the responsibility to protect correlative rights of producers and landowners when production is from a common source of supply. K.S.A 55-703 provides that whenever the available production of natural gas exceeds the market demand, then,

> "any person, firm or corporation having the right to produce natural gas from the common source of supply may produce only that portion of all the natural gas that may be currently produced without waste and to satisfy the market demands, as will permit each developed lease to ultimately produce approximately the amount of gas underlying the developed lease and currently produce proportionately with other developed leases in the common source of supply without uncompensated cognizable drainage between separately-owned, developed leases or parts thereof.
>
> "The commission shall regulate the taking of natural gas from any and all common sources of supply within this state in order to prevent the inequitable or unfair taking of natural gas from a common source of supply . . . ."

Thus, the KCC's duty under K.S.A. 55-703 is to prevent waste and protect correlative rights. Appellants argue that in order to issue its current order, the KCC redefined correlative rights. "Correlative rights" has been defined by the KCC in the past as follows:

> " 'Correlative rights' means that each owner or producer in a common source of supply is privileged to produce from that supply only in a manner or amount that will not injure the reservoir to the detriment of others, take an undue proportion of the obtainable oil or gas, or cause undue drainage between developed leases." K.A.R. 82-3-101(15).

The KCC argues it has not redefined "correlative rights," but that in addition to the definition contained in K.A.R. 82-3-101(15), the KCC must also apply the statutory provisions which further define correlative rights as those which only exist "currently." For support the KCC cites K.S.A 55-703, which states individuals have the right to produce gas from the common source of supply "that may be *currently* produced" and they may "*currently* produce proportionately with

other developed leases in the common source of supply." Appellants argue the KCC's position that it may define correlative rights as that which can be *currently* produced, effectively eliminates their right to regain, through long-term recovery of underages, their fair share of the gas in the Hugoton area.

Appellants also argue that the KCC's reliance on the language in K.S.A. 55-703, which includes the word "currently," misconstrues the statue, since it fails to take into consideration the qualifying phrase which follows in the statute. That phrase is "without uncompensated cognizable drainage between separately-owned, developed leases or parts thereof." Thus, the word "currently" allegedly is not allowed to be singled out when there are significant drainage problems. For support appellants cite *Cities Service Oil Co. v. State Corporation Commission*, 205 Kan. 655, 668-69, 472 P.2d 257 (1970), where it was held:

> "As indicated, drainage is inevitable in an active field such as the Hugoton. The deliverability formula contemplates counter drainage and thus provides compensated drainage in a subsequent period of time, recognizing the impossibility of applying the literal meaning of the word currently."

Appellants also cite the language of K.S.A. 55-703 which states correlative rights are to be determined according to what each lease will "ultimately produce." Appellants argue that if their underages are permanently cancelled here they will not be able to receive counter drainage and thus *ultimately* they will not receive a proper share of the common source of supply.

In support of its order, the KCC cites *Republic Natural Gas Co. v. State Corporation Commission*, 173 Kan. 172, 244 P.2d 1196 (1952), which discusses the application of the term "currently" in 55-703. In that case

an order of the KCC denying reinstatement of a cancelled underage was appealed. The appellants in that case argued if their underage in the Hugoton Field was permanently cancelled, their correlative rights would be violated. In affirming the KCC we stated: "This argument fails to take into consideration the time element in proration." 172 Kan. at 179. The court noted paragraph (p) was placed in the basic order by the KCC because of the difficulty involved in causing a well to produce exactly its allowable each month. Based upon this rationale, the court held the correlative rights which the KCC must protect pursuant to 55-703 include the portion of all the natural gas that may be *currently* produced, without waste and to satisfy the market demands. 173 Kan. at 180.

Appellants here argue *Republic* is clearly distinguishable from the instant case. In *Republic*, the KCC was engaged in *limiting* production in order to protect correlative rights. Here, appellants allege the commission inappropriately utilizes the language of *Republic* to support its attempts to *induce* greater production by giving the market incentives and thus create greater demand.

Appellants also argue the KCC has unlawfully delegated to the purchasers its authority to protect the correlative rights. The reasoning here is since gas cannot be stored but can only be produced when there is a purchaser, under the amendment to paragraph (p) it is up to the purchasers to take enough gas from the producers with significant underages to prevent the cancellation of those underages.

After careful consideration, we are led to the conclusion the KCC's new definition of correlative rights is incorrect. It ignores both K.S.A. 55-703 and K.A.R. 82-3-101(15). There the emphasis is on preventing the

inequitable and unjust taking of natural gas from a common source of supply with the objective of providing a way for each developed lease to ultimately produce the gas underlying it. The statutory reference to "currently produce" must be interpreted with the rest of the sentence. It is then apparent the legislature ordered current production to be proportionate with other leases in the pool, without drainage, to attain equity.

That, however, does not resolve this issue. The KCC order amending paragaph (p) of its basic Hugoton Field proration order does not necessarily conform to its own new definition of correlative rights with the emphasis on current production. The amended order provides each producer an opportunity to reinstate its cancelled underages and thus the right to ultimately recover the gas under its leases. As argued by the KCC, such an opportunity is all the KCC can provide as it is impossible to force current equal production from all wells in the common source of supply.

Some of the appellants also argue that the problem was caused by the KCC because it ignored the current market demand and set the allowables too high. Allowables have been set many times above the market demand. While this is true, the allowables were not appealed and are thus not at issue in this case. The issue is whether the order violates the provisions of K.S.A. 55-703.

Appellants next contend there is substantial evidence the KCC acted beyond its authority as established in K.S.A. 55-703, when it failed to prevent waste and ensure equitable taking but instead amended paragraph (p) to increase production in the Hugoton Field. We have held the KCC's authority is limited to that conferred by statute. *Bennett v. Corporation Commission*, 157 Kan. 589, 596, 142 P.2d 810 (1943).

The testimony of Ron Cook, the sole KCC witness, supported by Michael S. Daugherty, Mesa's witness, Jimmy Mogg of Panhandle and Robert M. Danos of KN Energy, provides the evidence the KCC relied upon in making its amendment. See *Colorado Interstate Gas Co. v. State Corporation Commission*, 192 Kan. 1 Syl. ¶6, 386 P.2d 266 (1963), *cert denied* 379 U.S. 131 (1964). Cook testified the purpose of the amendment was to increase production. The order of February 16, 1983, also states the purpose of the order is to increase production. Appellants argue this purpose is beyond the KCC's authority. For support, appellants note there are no statutes which give the KCC authority to encourage production. Appellants also cite *Rush v. King Oil Co.*, 220 Kan. 616, 556 P.2d 431 (1976), to uphold their position. In *Rush*, the trial court ordered the drilling and development of a particular oil and gas lease. The trial court held the development was required in order for the lessee to comply with the implied covenants of reasonable development and protection against drainage. This court held the trial court's order was not invalidated by the KCC proration order establishing allowables for production, stating that the purpose of K.S.A. 55-601 *et seq.* "is not to give the corporation commission the power to regulate development but rather to prevent waste and the unfair or inequitable taking of oil from any pool." 220 Kan. at 627. Appellants urge that the power to regulate development is similar to the power to encourage production, and is thus not allowed under Kansas law pursuant to *Rush*.

Appellants also cite *Thompson v. Consolidated Gas Co.*, 300 U.S. 55, 81 L.Ed. 510, 57 S.Ct. 364 (1937), for authority that the encouragement of production is beyond the authority of the KCC. In *Thompson*, the authority of the Texas Railroad Commission was questioned under a Texas statute which allowed the commis-

sion the power to regulate natural gas activity in the state for the purpose of preventing waste and protecting correlative rights. The commission had issued an order establishing allowables in certain fields at very low levels in an attempt to encourage producers to take gas from other fields, not subject to the order, which were substantially underproduced. The order was challenged arguing it was coercive and its purpose and effect was not to prevent waste or protect correlative rights but to "compel" pipelines to take gas for which no market existed. The United States Supreme Court held the order was inconsistent with the purposes of the Texas gas conservation statute and the proration orders setting the low allowables were invalid as they bore no reasonable relation to the purposes of the statute. The court found there was no waste evident in the gas fields which were under the subject orders. Appellants here thereby conclude that since the purpose of the amendment is specifically to increase and encourage production in the Hugoton Field and not to prevent waste or to protect correlative rights, the order is beyond the KCC's authority and is thereby void.

Appelless argue it is within the KCC's authority to determine when field conditions and demand for natural gas necessitate a change in the basic order. Appellees cite *Colorado Interstate Gas Co. v. State Corporation Commission*, 192 Kan. at 25, for authority that:

> "When waste, market demand, and correlative rights are in conflict the Commission must determine which is to be given preference. If the decision of the Commission is supported by evidence, the courts cannot interfere."

Appellees therefore argue it is completely within the commission's discretion to cancel the underages when it is determined the underages have affected market demand. Furthermore, the appelless argue the commission is only required to

> "afford each other the 'right or opportunity' to produce his share. As far as the Commission's duty under the basic order goes, it is fulfilled when each owner is legally 'free to produce' and not denied the 'right or opportunity' to produce his allowable." 192 Kan. at 25.

Hence, appellees argue the KCC has provided the opportunity to produce, which is within its authority.

Appellants next argue the order of the KCC is arbitrary and capricious. It is well established in Kansas that an order of the state corporation commission will be set aside as arbitrary, capricious or unreasonable if it is not based upon substantial competent evidence. *Southern Kansas Stage Lines Co. v Public Service Comm.*, 135 Kan. 657, 11 P.2d 985 (1932); *Colorado Interstate Gas Co. v. State Corporation Commission*, 192 Kan. at 14-15.

Appellants argue initially that the arbitrariness of the commission's disputed order can be determined from the fact that it is a change from its prior stand on the issue. For many years the commission followed a policy of ordering the reinstatement of cancelled underages when requested to do so if the purchaser was willing and able to take the gas. The orders reinstating cancelled underage were done "in protection of correlative rights and to permit said wells to produce their fair share of gas from under the field." The commission's current order, however, states that to protect correlative rights it must now *permanently* cancel underages which cannot be produced within the given time. This represents a change in the KCC's position. That, however, does not prove the KCC action was arbitrary, capricious or unreasonable. A regulatory body has authority to change

positions on an issue if the new position is supported by substantial, competent evidence. *Warburton v. Warkentin*, 85 Kan. 468, 476-77, 345 P.2d 992 (1959). Here there was evidence the Hugoton Field required additional production to protect correlative rights. Commission action was thus prompted.

Appellants next argue even if the KCC has authority to promote production, the KCC has no idea whether its order will have that effect, and hence the action is arbitrary. For support, appellants cite the testimony of the KCC's witness, Cook, who testified at the hearing that he only hoped his plan would be an incentive to production. Since the actual production will be dependent upon whether pruchasers decide to purchase this new abundant amount of gas from the Hugoton Field and there is no way the KCC can compel the purchase, there is no way to know if the KCC's order will actually produce the effect it desires. Additionally, appellants argue the order will not have the KCC' desired effect of increasing production because purchasers will have to choose between taking under their take or pay contracts or taking from the Hugoton producers. Since it would be quite costly to take from Hugoton and make the payments required under the other contracts, appellants argue the pipelines will not increase their Hugoton takes. Hence, appellants argue the order is unreasonable.

Appellants finally argue that the order is arbitrary and capricious because it promotes waste and permanently affects the correlative rights of the parties. For support, appellants argue that many experts testified at trial that if the order is followed which requires production within this short amount of time the increased production with the change in pressure will result in water production by the gas wells. This movement of water into the gas field will also result in waste in that it will cut off gas in some parts of the field, thereby causing substantial waste. Appellants also point to the drainage and counter drainage over the history of the field. If the underages are permanently cancelled those that have experienced underages will never be able to regain their full share of the gas since the amount they were allowed to take has been cut off by the KCC's order.

Panhandle Eastern argues the KCC's order is not arbitrary, citing *Republic Natural Gas Co. v. State Corporation Commission*, 173 Kan. 172, wherein we stated:

> "There is nothing hard and fast, unreasonable or arbitrary about the cancellation of accumulated underages. . . .
>
> "The entire matter, not of the cancellation, but of what effect the cancellation will have on future production of any well is a matter addressed to the judgment and discretion of the commission after a hearing." 173 Kan. at 181.

Appellants argue *Republic* is distinguishable from the instant case since it simply holds that cancellation will not result in violation of correlative rights so long as *actual* production is being spread among the wells in the field. Appellants contend this is not what the commission has been doing here. They contend instead of prorating actual production among the wells in the field, the KCC has allegedly been spreading fictional market demands, which are far in excess of the ability of many of the interstate markets to absorb.

The KCC responds that many of the experts at the hearing testified that the Hugoton Field is not presently in balance and that correlative rights have been and are currently being violated due to the severe underage problem. Appellants argue, however, the KCC's order

will not correct the problem. While the method of correcting a problem is generally within the KCC's sole discretion, unless it is arbitrary, capricious and ignores the evidence, then this court must hold the order improper.

Appellees contend it is within the discretionary authority of the commission to accept or reject any expert testimony presented. *Union Gas System, Inc. v. Kansas Corporation Commission*, 8 Kan. App. 2d 583, Syl. ¶1, 663 P.2d 304 *rev denied* 233 Kan. 1093 (1983). The facts to be considered and the weight to be accorded them are matters left to KCC discretion. See *Colorado Interstate Gas Co. v. State Corporation Comm.*, 192 Kan. 1, Syl. ¶6. The question, therefore, finally narrows to whether there was substantial competent evidence to support the KCC's order in this case.

The KCC through its expert, Ron Cook, whose testimony was corroborated by Michael S. Daugherty and Robert M. Danos, introduced evidence that the accumulation of underages in the Hugoton Field had rendered the field so out of balance it was seriously impairing the correlative rights of the landowners and operators. Cook testified:

> "Correlative rights have been and are currently being violated by the uncompensated drainage that is occurring due to the unratable taking of allowables between offsetting leases. Future projections of gas production from the Hugoton Field indicate that this trend of accumulating more underage and cancelled underage will continue for a number of years.
>
> "There is a definite possibility that near the end of many of the wells' productive lives, there will be a tremendous amount of cancelled underage that will never be reinstated due to the physical inability of the wells to make up such underage. This will result in a greater violation of correlative rights, because under the present provisions of Paragraph P of the basic order, there is no incentive to reinstate cancelled underage in a timely manner. . . ."

Cook's analysis and conclusions were seriously challenged by Lester Wilkonson, a petroleum engineer, whose testimony was adopted by all of the appellants. Mr. Wilkonson maintains the amendment to paragraph (p) will have the opposite effect to that desired by the commission. He agrees that more production is needed from the Hugoton Field but asserts it will not be obtained by the method chosen by the KCC. He further asserts that correlative rights of the owners and operators will be permanently damaged by the proposed cancellation of underages. He claims the schedule proposed for reinstating underages is tantamount to complete cancellation of them because with the weak market demand the pipelines cannot take enough additional gas from the producers to place them in an overage state. With regard to cancellation of underages, he testified:

> "We have gone through periods when moratoriums were in effect and no underage was cancelled. Too, the flexibility limits of cancelling underproduction and overproduction have also been changed from time to time. As long as underage could be reinstated, no one had serious objection to the cancellation provisions. However, I personally have felt that cancellation of a portion of underage actually removed the 'heat' from the purchasers to take gas. In other words, if the public record reflects only a portion of the underage, the purchaser's takes do not appear to be too far out of line. In my opinion, if any change is to be made in the cancellation provisions of paragraph "p," it should be to

place all underage, both present and cancelled, back on the report so we may take our heads out of the sand and see the true status of the individual wells connected to the various purchasers."

Michael S. Daugherty, a petroleum engineer for Mesa, had a different point of view:

"Mesa is aware of the recent reduction in the demand for natural gas industry-wide. It is our opinion that this reduced demand is due both to conservation efforts of the consumers, largely brought about by the increase in price, and the present business recession in the national economy. We are aware of the reduced markets of the interstate purchasers. However, the evidence presented by the purchasers and the Commission staff in the recent Market Demand hearings indicates that the Hugoton Field has suffered a proportionately greater reduction in the takes than the other fields from which the purchasers are buying gas. In Mesa's opinion this is not fair to the Hugoton producers, the royalty owners, the taxing entities within the state or to Kansas consumers."

He went on to say that purchasers have reduced their Hugoton Field purchases

"due to the existence of take or pay contract provisions in the purchasers' contracts in other fields and the more restrictive tolerance provisions in the basic proration orders of the other fields. In my opinion, this makes it easier to use Hugoton for storage than the other fields from which the purchasers buy gas."

In response to a question about the benefits of Hugoton gas to Kansas consumers, Mr Daugherty stated:

"[G]enerally speaking, the Hugoton Field gas is the

cheapest gas available to the purchasers. Any reduction in the cost of gas due to increased runs from Hugoton is flowed through to the Kansas consumer."

Daugherty continued:

"Mesa's intrastate purchaser, Kansas Power and Light Company, forecasts that approximately 37% (14 BCF of 38 BCF) of its main system gas for the winter period in 1982-83 will be obtained from Mesa out of the Hugoton and Council Grove Fields. This 14 BCF of gas is presently priced at approximately 67¢ per MCF. Low takes by other purchasers from the field and the resulting reduction in market demand from the Hugoton Field have necessitated KPL to seek additional short term supplies of gas. They have entered into a five (5) year contract with Cities Service Gas for approximately 8 BCF of gas per year. The November 1982 price of this gas will be in excess of $4.00 per MCF. The difference between the price of this gas and Hugoton 67¢/MCF gas from Mesa will be passed on to their Kansas customers."

In response to questions, Daugherty then testified:

Q: What will KPL's cost be for this gas?

A: It appears that over the next five years KPL will purchase up to about 40 Bcf at over $4.00/Mcf at a total cost of about $160 million.

Q: How much would that amount of gas cost KPL if it were purchased from Mesa at 67¢/Mcf?

A: About $27 million.

Q: Will any of the gas sold to KPL by Cities Service Gas come from the Kansas Hugoton Field?

A: It is possible that some of it could come from

the Kansas Hugoton Field, and to the extent that it does it will help to increase Cities Service's runs from the field. However, it should be pointed out that the producers and royalty owners will not share in the $4.00-plus price that KPL and its customers pay for this gas. Cities will be paying the producer an average of approximately 50¢/Mcf, the present NGPA Section 104 price, for whatever portion of the 8 Bcf of gas that is produced from Hugoton. The royalty owners and Kansas taxes are paid based on the 59¢/Mcf gas price. If the market demand, allowables and production in the field were at the level they have been in the past, 500 to 550 Bcf per year, KPL's customers could be receiving their requirements from Mesa at a much lower cost. To my knowledge, there is no gas being produced and sold by producers from the Hugoton Field that even approaches the $4.00-plus price that KPL is to pay Cities Service."

The testimony shows the KCC had evidence from experts who held different point of view. KCC chose to believe Cook and Daugherty. That is the KCC's prerogative. In *Colorado Interstate Gas Co. v. State Corporation Commission*, 192 Kan. 1, we stated:

> "In considering the validity of the Commission's determination, the courts can consider only the statutes granting the Commission's authority and the Commission's basic order with such amendments as are properly made thereto. The determination is a question of fact. What facts are to be considered and the relative weight to be accorded them are matters left to the Commission's discretion. Unless the determination is arbitrarily or capriciously made without supporting evidence, the courts cannot interfere and substitute their judgment for that of the Commission. The question for the reviewing court is the power of the Commission to make the order, not its wisdom, propriety or expediency in having made it." 192 Kan. at 18.

The weight and logic of the evidence raises serious questions of the producers' ability to persuade the purchasers to take enough additional gas to acquire an overproduced state in time to avoid permanent cancellation of underages. However, there is substantial competent evidence in the record indicating otherwise under ideal circumstances. Thus, our doubts about the soundness of the KCC decision are not grounds for reversal. It is a matter of judgment and we are not permitted to substitute our judgment for that of the commission.

The KCC's dilemma is apparent. It was concerned about the dramatic decline in production from Hugoton and its effect on owners, producers and consumers. It sought ways to increase Hugoton production. It increased allowables in spite of reduced purchaser nominations and other evidence of less market demand. As a result, the disparity between overproducers and underproducers increased. It is arguable whether reduced production from the field was caused by a conscious choice of producers and pruchasers to supply their demands from other sources and make Hugoton Field a storage facility or whether it was simply caused by reduced market demand. The KCC believed the former and amended paragraph (p) of the basic order to provide an incentive for production by permanently cancelling underages if not recovered on an accelerated schedule. Even though the testimony of Mr. Wilkonson was quite persuasive that the amendment would not have the desired effect of increasing production, but would instead result in a cancellation of all underages, we find there was substantial competent evidence to

support the KCC's conclusion that correlative rights were being compromised by the excessive underages. This is the threshold issue which must be met before the KCC is authorized to make such orders as are necessary to correct the problem. While selling gas is not a function of the KCC, except tangentially through setting allowables, nor is the providing of incentives for additional production a KCC function, when additional production is needed to protect correlative rights, the KCC has authority to create such incentives. K.S.A. 55-703 provides:

> "The commission shall regulate the taking of natural gas from any and all common sources of supply within this state in order to prevent the inequitable or unfair taking of natural gas from a common source of supply by any person, firm or corporation and to prevent unreasonable discrimination in favor of any one common source of supply as against another and in favor of or against any producer in any common source of supply."

We conclude the KCC acted lawfully and reasonably in this case.

Appellants next argue the KCC order improperly interferes with federal regulation of natural gas in interstate commerce.

In *Northern Gas Co. v. Comm'n.*, 372 U.S. 84, 9 L.Ed.2d 601, 83 S.Ct. 646 (1963), the United States Supreme Court struck down an order of the commission requiring Northern Natural Gas and other purchasers in the Hugoton Field to take ratably from the wells to which they were connected. The court reminded the commission that Congress enacted a comprehensive scheme of federal regulation of all wholesales of natural gas in interstate commerce, which leaves no room for direct or indirect regulation by the states that affects or may affect the ability of the federal power commission (now the Federal Energy Regulatory Commission [FERC]) to regulate completely and effectively the transportation and sale of natural gas in interstate commerce. The commission's ratable take order was invalidated under the following holding:

> "Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual cost to wholesale customers who sell to consumers in other States. This relationship is a matter with respect to which Congress has given the Federal Power Commission paramount and exclusive authority." 372 U.S. at 92.

Appellants argue, and the trial court agreed, that the effect of the KCC's order, if the purchasers decided to divert purchasers from other fields to prevent the cancellation of their underages in Hugoton, would decrease production from other fields in other states. The district court specifically found the order would induce increased production from the Hugoton Field and found that "[a]s a practical matter, the change in 'p' will . . . cause a change in the 'mix' of natural gas which pipelines transport for sale many miles away."

The district court found, however, that since the KCC order deals with producers of natural gas, rather than specifically ordering the purchasers to do anything, it falls within the specific exemption of the Natural Gas Act. This is consistent with the KCC's position that the obligations imposed by the order are on the producers, who are exempt from the Federal act, not the purchasers.

Appellants argue the nature of gas automatically means the order controls the purchasers. Since gas may

not be produced unless there is a purchaser, the order affects purchasers equally with the producers. Appellants note the testimony of Mr. Cook, the KCC's witness, who testified the purpose of the order was to effect production in the Hugoton Field. Appellants further note *Northern Gas*, which discusses the infringement by the states in the area of natural gas production and purchase:

> "The Natural Gas Act precludes not merely *direct* regulation by the States of such contractual matters. . . .
>
> "The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, [citation omitted] or for state regulations which would indirectly achieve the same result." 372 U.S. at 91.

Appellants also point out all that need be shown is an "imminent possibility of collision" between the KCC's order and the federal scheme of regulation. 372 U.S. at 92.

Appellees argue *Northern Gas* is distinguishable from the instant case. There the orders were "unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for release after transportation in interstate commerce." 372 U.S. at 92. The United States Supreme Court noted that criminal sanctions for violations of the orders would fall, not upon the producers, but upon the pipeline purchaser. The order in the instant case gives us pause. It obviously is intended for purchasers, but is directed to producers. Hence, the question which this court must decide is whether this indirect effort to influence purchasers meets the standards noted in *Northern Gas*, which would preclude state regulation in this area. As stated in *Northern Gas*, federal regulation does not apply to the production or

gathering of natural gas. Interpreted in a narrow sense, as suggested by *Northern Gas*, the matter of allowables must be construed to pertain to production. The state has regulatory authority over production. The rules on underages are a part of production regulation and thus are not violative of the federal act, even though purchasers are indirectly caught in the backwash.

Appellants next argue the doctrine of equitable estoppel bars the enforcement of the KCC order amending paragraph (p). Appellants allege the KCC order has the effect of making it illegal to reinstate underage volumes which were previously allowed to accumulate legally. Appellants note the order does not operate prospectively by prohibiting the accumulation of future underage or reducing the extent of overproduction after which underage would be cancelled; rather, the order sets an "arbitrary" period of time for producers and purchasers to bring wells into an overproduced status, seek reinstatement of the cancelled underage, and produce the same. Appellants argue this is inconsistent with the doctrine of equitable estoppel. In *Bowen v. Westerhaus*, 224 Kan. 42, 46, 578 P.2d 1102 (1978), this court reviewed the law concerning equitable estoppel and held:

> "Equitable estoppel is the effect of the voluntary conduct of a person whereby he is precluded, both at law and in equity, from asserting rights against another person relying on such conduct. A party asserting equitable estoppel must show that another party, by its acts, representations, admissions, or silence when it had a duty to speak induced it to believe certain facts existed. It must also show it rightfully relied and acted upon such belief and would now be prejudiced if the other party were permitted to deny the existence of such facts."

Appellees argue in response that estoppel against

a government agency should not be invoked except in rare and unusual circumstances and may not be invoked where it would serve to defeat the effective operation of a policy adopted to protect the public. 31 C.J.S., Estoppel §138. Appellants argue the order of the KCC in dispute here is not a policy adopted to protect the public or even to fulfill the duties of the KCC; rather, it is merely to induce an increase in production.

Appellees note there is no vested right to produce gas in the Hugoton Field. Further, the KCC must be given, and has been given, discretion to amend the basic order in the public interest when the evidence indicates that conditions in the Hugoton Field warrant a change. See *Colorado Interstate Gas Co. v. State Corporation Comm.*, 192 Kan. 1, 28-29, 386 P.2d 266 (1963). Because authority has been granted to the KCC to modify the order when it deems necessary, appellants cannot reasonably relay on any prior orders of the KCC to such an extent as to invoke the doctrine of equitable estoppel. A regulatory body's orders are not a commitment and may be changed, reversed or amended in lawful and based on substantial competent evidence. This issue must fail.

Appellee Panhandle Eastern argues this appeal was improperly taken directly to the Supreme Court. Appellants, however, note this appeal was taken from the district court pursuant to K.S.A. 55-606. That statute provides that "[a]ppeals to the state supreme court may be taken from the judgment of the district court as in other civil actions." Panhandle Eastern argues civil actions may be taken directly to the state Supreme Court only "from a final judgment of a district court in any civil action in which a statute of this state or the United States has been held unconstitutional. . . ." K.S.A. 1984 Supp. 60-2101. Thus, appellee argues, since this case does not involve the constitutionality of a statute, this appeal was improperly brought to the Supreme Court instead of the Court of Appeals.

There are several statutes still lingering on the books which provide for a direct appeal to the Supreme Court under circumstances other than those noted in K.S.A. 1984 Supp. 60-2101. Among these are K.S.A. 55-606. Professor Gard in his comment to K.S.A. 60-2101 states:

> "Note should be taken of any special statutes which provide for review of judicial or quasi judicial orders of certain administrative agencies by direct appeal to the supreme court. Such statutory provisions, until amended, should be considered as limitations on the court of appeals authority under this section." 2 Gard's Kan. C. Civ. Proc. 2d Annot. §60-2101, p. 89 (1979).

Hence, since this statute has not been amended the legislature has clearly intended appeals under K.S.A. 55-606 to go directly to the Supreme Court. This argument is without merit.

Intervenor Mesa Petroleum Co. argues the pipelines do not have standing in this case. Mesa reasons that the rights of the mineral owners are commonly referred to as correlative rights. Those who possess correlative rights are the mineral interest owners. The Kansas Supreme Court has defined "mineral interest" to be:

> "The term 'mineral interest' as commonly used refers to the oil and gas in place and constitutes a present ownership of an interest in real property. [Citation omitted.] A prime characteristic of a mineral interest is the right to enter the land to produce and carry on production activities. This right may be leased to others." *Stratmann v. Stratmann*, 204 Kan. 658, 662, 465 P.2d 938 (1970).

Since the pipeline purchasers have no mineral interest in the Hugoton Field, they have no correlative rights. Hence, Mesa argues they lack standing to appeal an order of the KCC relating solely to the prevention of waste and protection of correlative rights.

Appellants argue this issue was raised before the district court and denied. Appellees did not cross-appeal this issue, hence, the issue is not properly before this court. We have consistently held the right to an appeal is neither vested nor a constitutional right, but is strictly statutory in nature. See *In Re K-Mart Corp.*, 232 Kan. 387, Syl. ¶2, 654, P.2d 470 (1982). Thus, since a cross-appeal was not taken this court will not consider this issue.

The judgment of the trial court is affirmed.

SCHROEDER, C. J., dissenting: As applied to this case, the KCC's duty under K.S.A. 55-703 is to *prevent waste and protect correlative rights* in the production of natural gas from the Hugoton Field, located in Kansas. The KCC is obligated by legislative mandate, where regulation is required, as here, to permit production of gas from the common source of supply of "only that portion of all the natural gas that may be currently produced without waste and *to satisfy the market demands*, as will permit each developed lease to ultimately produce approximately the amount of gas underlying the developed lease and currently produce proportionately with other developed leases in the common source of supply without uncompensated cognizable drainage between separately-owned, developed leases or parts thereof." K.S.A. 55-703. (Emphasis added.)

The pipeline companies that purchase natural gas in Kansas and other states for transportation in interstate commerce for resale have a right to purchase gas

from their contracted dedicated reserves. Natural gas cannot be produced unless a purchaser is ready to buy it; it cannot be stored in a tank on the lease. *Northern Natural Gas Co. v. State Corporation Commission*, 188 Kan. 355, 360, 362 P.2d 599 (1961), *rev'd* 372 U.S. 84 (1963). Thus it is the purchasers who supply the market to the field, which according to the basic order is supposed to be prorated among the wells in the field.

In this case the KCC continuously fixed allowables for some time far in excess of requirements to supply the demand for natural gas which resulted in a huge underage of production in the Hugoton Field. This underage has been accruing since January 1, 1967. Since 1975 alone, the KCC has granted 275 BCF allowable in excess of actual production.

In my opinion, the KCC has exceeded its statutory authority in fixing allowables far in excess of demand. This is clearly indicated by the huge underage existing in the Hugoton Field. This in turn has had its impact on drainage in the field illustrated by the fact that Mesa has no underage, but is in a state of overproduction. The statutory obligation of KCC to protect correlative rights has, therefore, been ignored.

I would reverse and hold the KCC order amending the basic proration order by changing paragraph (p) to be invalid because it exceeds legislative authority. The fact that some expert may venture an opinion that this action is the solution to an existing problem in the field is wholly immaterial.

Even assuming arguendo that this infirmity is ignored, as the court in its opinion has done, the KCC has no jurisdiction to proceed on the theory it has adopted to amend the basic proration order. Federal preemption excercised through FERC's interstate regulatory authority nullifies the KCC order.

Many of the pipeline systems which transport natural gas from the Kansas Hugoton Field are integrated with pipeline systems connecting other gas fields, and natural gas from the Kansas field is thereby commingled with gas from other fields, including the Oklahoma and Texas portions of the Hugoton Gas Field. *Colorado Interstate Gas Co. v. State Corporation Comm.*, 192 Kan. 1, 5, 386 P.2d 266 (1963), *cert. denied* 379 U.S. 131 (1964). The connected reserves of the interstate purchasers in the field are a significant part of their total system-wide reserves. Any increase or decrease in the volumes of gas purchased within the state of Kansas changes the volumes of gas purchased outside the state (change in the "mix") and will change the average cost of gas to the purchasers. FERC's exclusive jurisdiction extends to the regulation of the intricate relationship between the purchasers' cost structures and the eventual cost to distributors who sell to consumers in other states. *Northern Gas Co. v. Kansas Comm'n*, 372 U.S. 84, 9 L.Ed.2d 601, 83 S.Ct. 646 (1963).

Although the commission contends that its order is directed at producers not purchasers, its real purpose is to create an impact on purchasers' business decisions concerning the makeup of their interstate gas mix, with an eye toward making it economically prohibitive for such purchasers not to purchase increased substantial volumes of gas from the Kansas Hugoton Field even at the expense of their purchases from other states. The commission has not been correlating allowables with demand, ever seeking to compel purchasers to purchase more Kansas gas. Faced with mounting underages, increasing the imbalance in the field, the commission now attempts to use its ultimate weapon, the power to cancel forever the right to purchase connected reserves of a

pipeline, insofar as it fails to purchase those volumes within the arbitrary period allotted by the commission.

This is clear from the commission's own findings. It found in the order that the correlative rights of a producer is the right to participate in a given market for a given period of time. (This does not compare with the definition of correlative rights in the commission's own Rule 82-3-101[15]). It found that the problem with correlative rights violation *does not result from the assignment of the allowables*, but rather from the failure of producers and pipelines to take production from the field. It found that its previous flexible reinstatement provision induced a lack of incentive to produce resulting in depriving some operators of the opportunity to participate in a given market, and that this resulted in discrimination. "It is the purpose of this Order not to restrict production of gas but to encourage it." Its interest was to provide sufficient incentive to "produce allowables," to encourage "production of current allowables," and create an incentive to produce "by tightening the provisions of the basic order with regard to the cancellation of underage."

Thus, the net purpose of the commission order is to require the production and purchase of the "assigned allowable" by making prohibitive the economic consequences facing the pipeline purchasers for not doing so, *viz.*, the permanent cancellation of their right to purchase from their connected reserves in the Kansas Hugoton Field for which assigned allowables had previously been assigned.

The district court looking at the same facts as were presented to the commission, specifically found that the order would induce increased production from the field, and found that "[a]s a practical matter, the change in '(p)' will . . . cause a change in the 'mix' of natural gas

which pipelines transport for sale many miles away."

Thus, the district court made the basic finding of invalidity, but tried to avoid it by concluding that since the KCC order deals with the producers of natural gas, it falls within the specific exemption of the Natural Gas Act. This coincides with the commission's position that the obligations imposed to file applications for reinstatement are on the producers not the purchasers, and that the order deals solely with conservation matters.

But under the cloak of the "producing or gathering" exemption in the Natural Gas Act, under the pretense of promulgating a conservation regulation under reserved police powers, the Kansas Corporation Commission has in reality promulgated a regulation *the indirect result of which, and the precise purpose of which, is to invade and infringe upon the exclusive jurisdiction of FERC to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act. Northern Gas Co. v. Kansas Comm'n*, 372 U.S. 84.

The *Northern* case is a landmark decision. It arose out of "ratable take" orders by the Kansas Corporation Commission requiring a pipeline purchaser to purchase gas from a producer in no higher proportion to the allowables than from the wells of other producers. The U.S. Supreme Court held that the orders invaded the exclusive jurisdiction which the Natural Gas Act had conferred upon the Federal Power Commission over the sale and transportation of natural gas in interstate commerce for resale. The court specifically held:

> "Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate

> the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States. This relationship is a matter with respect to which Congress has given the Federal Power Commission paramount and exclusive authority. See *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 610 [, 88 L.Ed. 333, 64 S.Ct. 281 (1944)]. The prospect of interference with the federal regulatory power in this area is made even more acute by the fact that criminal sanctions imposed by the state statute for noncompliance fall upon such purchasers and not upon the local producers. Therefore, although collision between the state and federal regulation may not be an inevitable consequence, there lurks such imminent possibility of collision in orders purposely directed at interstate wholesale purchasers that the orders must be declared a nullity in order to assure the effectuation of the comprehensive federal regulation ordained by Congress." 372 U.S. at 92.

But the commission says that since this is a conservation matter reserved to the states under the production or gathering exemption (15 U.S.C. § 717[b] [1982]), and because it is not directed to pipeline purchasers, but rather only to producers, *Northern* does not apply. The answers to these contentions are (a) this is not really a conservation matter because the only viable testimony in the record shows clearly that waste will be caused, not prevented, by the orders, and that correlative rights will be violated not protected by the order; (b) even if the foregoing were not true, and irrespective of whether there is a reasonable state purpose to be served by the order, it is invalid because the Natural Gas Act and FERC jurisdiction thereunder is comprehensive, and the Act's application from state to

state will not depend upon kaleidoscopic variations in state law; (c) even if the order be not directed at purchasers, its indirect effect is to cause a modification in the interstate mix of gas on the Northwest Central System (as the district court found), and this is enough to tip it into constitutional invalidity.

First, the order will cause waste, not prevent it. "The dominant purpose of the Gas Conservation Statute is to prevent waste," *Colorado Interstate Gas Co.*, 192 Kan. at 25. But the undisputed testimony of Lester Wilkonson, the reputed expert on the Hugoton Field, is that the order may cause waste by inviting damaging water incursion as a result of a severe pressure drop, which might result in waste in the ground because of loss of communication with the gas reservoir.

Moreover, the commission practices of setting allowables in excess of the actual market demand have created rampant discrimination between the wells in the field. Thus, some wells such as Mesa's wells connected to KP&L with a higher proportionate intrastate market demand, have been permitted to produce a higher proportionate part of their reserves than the majority of wells in the field connected to the interstate pipelines, such as Northwest Central and others, which have a plummeting market and no place to put the gas. The Mesa acreage adjoins that from which Northwest Central purchases. Therefore, the result of cancellation under this order will be to cement for all time that discrimination, and this will no longer permit the corrective or compensatory drainage which was the hallmark of the prior commission order for years. KP&L's intrastate customers will benefit, and Northwest Central interstate customers will be prejudiced. Compare *Penna. v. West Virginia*, 262 U.S. 553, 67 L.Ed. 1117, 43 S.Ct. 658 (1923), where the attempt to withdraw a large volume of gas from an established interstate commerce current so as

to preferentially benefit local consumers in the state where the gas was produced was an unconstitutional interference with interstate commerce.

The commission tries to contend that there is a viable conservation purpose served by this order, but simply calling the order a conservation order does not make it one. The fact remains that the purpose of the order and its effect, indirect or otherwise, is to change the interstate gas mix by inducing more Kansas gas to be taken.

> ". . . 'Acts generally lawful may become unlawful when done to accomplish an unlawful end, *United States v. Reading Co.*, 226 U.S. 324, 357, and a constitutional power cannot be used by way of condition to attain an unconstitutional result.' *Western Union Telegraph Co. v. Foster*, 247 U.S. 105, 114." *Gomillion v. Lightfoot*, 364 U.S. 339, 347-48, 5 L.Ed.2d 110, 81 S.Ct. 125 (1960).

The Natural Gas Act is a comprehensive scheme of federal regulation of "all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 682, 98 L.Ed. 1035, 74 S.Ct. 794 (1954); *Northern Gas Co. v. Kansas Comm'n*, 372 U.S. at 91.

The Kansas Supreme Court has sustained the ratable take order, although recognizing that it applied to purchasers, because the object of the Kansas conservation statute (K.S.A. 55-703) could not be accomplished "unless that taker or purchaser can be controlled." *Northern Natural Gas Co. v. State Corporation Commission*, 188 Kan. at 360. But the U.S. Supreme Court had no trouble with this. Merely because some of the incidences of the order relate to production and gather-

ing does not bring the order into the ambit of the exemption, where other incidences of the order impact directly or indirectly upon transportation and wholesales of natural gas in interstate commerce.

Since the power of Congress under the Supremacy Clause is supreme, it is up to the State of Kansas to mold its policy of regulation of production and gathering so as not to impinge upon the exclusive jurisdiction of FERC over interstate transportation and wholesales.

The U.S. Supreme Court in *Northern* said:

"The Natural Gas Act precludes not merely *direct* regulation by the states of such contractual matters . . . .

"The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas . . . or for state regulations which would indirectly achieve the same result." 372 U.S. at 91.

Since the *Northern* case, there have been a number of additional holdings in an unbroken line of cases saying the same thing. *Public Service Com'n v. Federal Energy Reg.*, 610 F.2d 439 (6th Cir. 1979).

It is respectfully submitted the order of the KCC under attack is invalid.

APPENDIX C

Case Nos. 83 C 20
83 C 21
83 C 22
83 C 23
83 C 24

IN THE SIXTEENTH JUDICIAL DISTRICT DISTRICT COURT, GRAY COUNTY, KANSAS CIVIL DEPARTMENT

NORTHERN NATURAL GAS COMPANY; K N ENERGY, INC.; NORTHWEST CENTRAL PIPELINE CORPORATION; AMOCO PRODUCTION COMPANY; and COLORADO INTERSTATE GAS COMPANY,
Petitioners

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, MICHAEL LENNEN, Chairman, RICHARD C. (PETE) LOUX, Commissioner, PHILLIP R. DICK, Commissioner, and their respective Successors in Office
Respondents

JOURNAL ENTRY OF JUDGMENT

NOW on this 7th day of November, 1983, this matter comes on for consideration of the Petitions for Judicial Review filed by the captioned petitioners herein; Mark H. Adams II, Wichita, Kansas, appearing on behalf of Northern Natural Gas Company; John Cary, Oklahoma City, Oklahoma, and Mark H. Adams II, appearing on behalf of Northwest Central Pipeline Corporation; Timothy E. McKee, Wichita, Kansas, appear-

ing on behalf of K N Energy, Inc.; Timothy E. McKee, Wichita, Kansas and Kim Conklin, Colorado Springs, Colorado, appearing on behalf of Colorado Interstate Gas Company; Ralph R. Brock, Wichita, Kansas, appearing on behalf of Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum, Inc.; Glenn D. Young, Jr., Wichita, Kansas, appearing on behalf of Amoco Production Company; Richard C. Byrd, Ottawa, Kansas, appearing on behalf of Mesa Petroleum Co.; Charles H. Apt III, Wichita, Kansas, appearing on behalf of Panhandle Eastern Pipeline Company; Gregory J. Stucky, Wichita, Kansas, appearing on behalf of The Southwest Kansas Royalty Owners Association and Patricia A. Gorham, Topeka, Kansas, appearing on behalf of the State Corporation Commission of the State of Kansas.

After having reviewed the record on appeal and all of the evidence and exhibits submitted therein; having considered the briefs of the parties and the suggested findings of fact and conclusions of law and having considered arguments of counsel and being duly advised in the premises, the Court, on November 21, 1983, made the following findings of fact and reached the following conclusions of law:

FINDINGS OF FACT

1. Petitioners, Northern Natural Gas Company, Northwest Central Pipeline Corporation, Colorado Interstate Gas Company, K-N Energy, Incorporated, and Amoco Production Company, have filed their petitions for judicial review in this Court from the Corporation Commission's Order dated February 16, 1983, which amended paragraph (p) of the Basic Order for the Kansas-Hugoton Gas Field. Petitioners had heretofore timely filed their petition

for rehearing and the petitions in this Court were duly and timely filed upon their hearing being denied. This Court has jurisdiction of the issues raised therein. Mesa Petroleum Co., Panhandle Eastern Pipeline Co., Southwest Kansas Royalty Owners Association, Cabot Petroleum Corp., Northern Pump Co., Graham-Michaelis Corp., and Kansas Petroleum, Inc. were granted the status of intervenors in the present action.

2. The Hugoton Gas Field is considered to be one of the largest known reservoirs of natural gas in the world, spanning approximately 160 miles north and south and approximately 72 miles east and west of its widest point. The field covers portions of 9 counties in the southwest corner of Kansas, including Gray County, which is known as the Kansas-Hugoton Gas Field and the field extends through the Oklahoma Panhandle into several counties of northern Texas.
3. There are presently more than 4,000 producing wells in the Kansas-Hugoton Gas Field and the field has long been considered to be fully developed.
4. Major purchasers of gas produced in the Kansas-Hugoton Field are Northern Natural Gas Company, Northwest Central Pipeline Corporation, Colorado Interstate Gas Company, Kansas Power and Light Company, Kansas-Nebraska Natural Gas Company and Panhandle Eastern Pipeline Company.
5. The purchaser, Kansas Power and Light is connected mostly to wells produced by Mesa Drilling Company and its demand for intrastate market is stable and currently greater on a connected deliverability basis than that of the other companies. The Mesa Wells connected to KP&L are over-produced. While, on the other hand, the wells

connected to the Petitioners in this action are under-produced.

6. Five other pipelines, which would be Northern Natural Gas Company, K N Energy Company, Northwest Central Pipeline Company, Amoco Production Company and Colorado Interstate Gas Company, are also interstate pipeline purchasers. To varying degrees in recent years, their markets have declined severely because of conservation, Federal intervention, competition with alternate fields and the recession. In 1982, natural gas sales fell by one-third and the Kansas-Hugoton Field production fell by 42.6%.

7. Due to the varying market conditions of the purchasers in the field, divergent rates of takes or purchases are inevitable. Throughout the regulated life of the field, every purchaser has gone through periods of overproduction of allowances, and of periods of making up prior underproduction and the various purchasers are not in the same phase of the cycle at the same time.

8. Due to the present economic conditions and loss of gas markets and the terminations of market demands for the field by the Commission commencing in 1975, the field, as a whole, presently, is underproduced. As of September 1, 1982, the current noncancelled underage was 204.5 billion cubic feet (Bcf) which was an increase of approximately 60 Bcf from September 1, 1981, with the situation getting worse. The underage cancelled during the period from January 1, 1967, to August 1, 1982, which remained unreinstated as of September 1, 1982, was approximately 314 Bcf. As shown by the monthly Proration Reports for the field issued by the Commission, an additional 86.9 Bcf of the underage has

been cancelled for the period from September 1, 1982, to September 1, 1983.

9. In order to maintain some type of orderly development of this field, the Commission first issued its basic order for the Hugoton Gas Field in Kearney, Finney, Grant, Morton, Haskell, Stevens, Seward, Stanton, Gray and Hamilton County, Kansas, on March 19, 1944, pursuant to its statutory authority. As part of the basic Proration Order for the Kansas-Hugoton Field a deliverability formula was established for use in the assigning of allowables to the wells producing from the Kansas-Hugoton Field. To allow some flexibility to the producers in the field the Commission established production tolerances for over and underproduction of the allowable, which is set by the Commission as part of the market demand proceedings. The tolerance provisions are set forth in Paragraph "P" of the basic orders.

10. An order for a general investigation of the basic Proration Order for the Kansas-Hugoton Field was properly issued on March 15, 1982. The problem concerns correlative rights which were being violated, but this does not result from the assignment of the allowable, but rather from the failure of producers and pipeline purchasers to take production from the field. The lack of incentive to produce is supported by the extreme tolerance provisions of the Proration Order and results in depriving some operators of the opportunity to participate in the given market. Paragraph "P", prior to the change, did not provide operators sufficient incentive to produce gas.

11. The change in paragraph "P" tightens the provitions of the Basic Order with regard to cancellation

of "Underages". This will, in turn, affect the right to produce and purchase heretofore allowed gas from the field. It will, however, provide greater incentive for operators to produce and should induce increased production in the field.

12. As a practical matter, the change in "P" will cause some permanent loss of underages (allowables) due to market conditions and will also cause a change in the "mix" of natural gas which pipelines transport for sale many miles away.

CONCLUSIONS OF LAW

1. The Commission has, from the beginning of the Proration, recognized the standing of the pipeline purchasers to institute and participate in proceedings, to appear before it, and to appeal from these rulings to the Kansas Courts. Thusly, their appeals should not be summarily dismissed.
2. Since the Basic Proration Order for Kansas-Hugoton Field was first issued in 1944, the Commission has, from time-to-time, amended the order with regard to provisions relating to a cancellation of the underage in the field. The amendments have been necessitated by changes in field conditions and the market demand for natural gas produced in the field. The modification of the rules of the field is in keeping with the responsibility of the K.C.C. to regulate the taking of natural gas in order to prevent inequitable or unfair taking of gas and prevent unreasonable discrimination in favor of, or against, any one producer in the field.
3. The Commission's Order of February 16, 1983, applies to all producers in the field and is for the purpose of preventing unfair and inequitable taking of gas by any person. The order is in keeping

with the Commission's responsibility set forth in K.S.A. 55-703.

4. The correlative rights of a producer is the right to participate in a given market for a given period of time. The Commission's responsiblity to protect the correlative rights is fulfilled when operators are permitted to currently produce their assigned allowable. However, when an operator fails to produce that allowable over a period of time and an underage is accrued to the extent, it is in the excess of that allowed by the provisions of the Basic Proration Order, the Commission has the authority to order such underage permanently cancelled.
5. Since this K.C.C. Order deals with the producers of natural gas it falls within the specific exemption of the Federal Natural Gas Act. This exemption allows the State to regulate the "production or gathering" of natural gas.
6. The Commission's Order changing Paragraph "P" of the Basic Proration Order of Hugoton Field is reasonable and lawful and is based on substantial, competent evidence and the order of the Commission dated February 16, 1983, and the Order on Rehearing dated April 14, 1983, are hereby affirmed.

IT IS, THEREFORE, ORDERED, ADJUDGED AND DECREED that the Order of the State Corporation Commission dated February 16, 1983, and the Order on Rehearing dated April 14, 1983, are hereby affirmed.

On November 2, 1983, this Court entered an Order staying until January 30, 1984, the requirement of the Commission's Order of February 16, 1983, for the filing of applications for reinstatement of underage

cancelled prior to January 1, 1975, by reason of the pendency of these judicial review proceedings. The Order of this Court of November 2, 1983, is reaffirmed.

IT IS SO ORDERED.

DISTRICT JUDGE

APPROVED:

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APPENDIX D

Docket No. C-164

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS CONSERVATION DIVISION

BEFORE COMMISSIONERS: RICHARD. C. (PETE) LOUX, Chairman, JANE T. ROY, PHILLIP R. DICK

IN THE MATTER OF ESTABLISHING RULES AND REGULATIONS RELATING TO THE PRODUCTION, SALE, AND CONSERVATION OF NATURAL GAS IN THE HUGOTON FIELD IN KEARNY, FINNEY, GRANT, HASKELL, MORTON, STEVENS, SEWARD, STANTON, GRAY AND HAMILTON COUNTIES, KANSAS.

ORDER

NOW, the above-captioned matter comes on for consideration and determination before the State Corporation Commission on the general investigation into the provisions of the basic order for the Hugoton Gas Field, specifically the provisions of Paragraph (P) of the basic order. This matter comes before Commissioners, Richard C. (Pete) Loux, Chairman; Jane T. Roy; and Phillip R. Dick.

The hearing was held for the purpose of considering modification of the commission's existing policy set forth in Paragraph (P) of the basic Proration Order with regard to over and under production from the field. The hearing was held November 3, 1982, at Wichita Royale, 125 N. Market, Wichita, Kansas. The appearances were as follows:

Bernard E. Nordling, Hugoton, Kansas, Dale Stucky, and Greg Stucky, Wichita, Kansas, on behalf

of Southwest Kansas Royalty Owners Association.

Timothy E. McKee, Wichita, Kansas, and Tim Conklin, Colorado Springs, Colorado, on behalf of Colorado Interstate Gas Company (or Colorado Interstate).

Jerome E. Jones, Wichita, Kansas, on behalf of Mobil Oil Corporation and Northern Natural Gas Producing Company (or Northern)

Jerome E. Jones and Raymond Brummett, Wichita, Kansas, on behalf of the Federal Land Bank of Wichita.

Jerome E. Jones, Wichita, Kansas, on behalf of Anadarko Production Company (or Anadarko).

B. J. Heckert and Glenn D. Young, Wichita, Kansas, on behalf of Amoco Production Company (or Amoco).

Gary Paulson, Denver, Colorado, on behalf of Amoco Production Company.

Stanford Smith, and Stanford Smith, Jr., Wichita, Kansas on behalf of Cities Service Company (or Cities).

Patrick J. McCarthy, Omaha, Nebraska, Mark H. Adams, II, and Don Bostwick, Wichita, Kansas, on behalf of Northern Natural Gas Company.

John Cary, Oklahoma City, Oklahoma, Mark H. Adams, II, and Don Bostwick, Wichita, Kansas, on behalf of Cities Service Gas Company.

James Daross, El Paso, Texas, Don Bostwick, and Mark Adams, II, Wichita, Kansas, on behalf of El Paso Natural Gas Company (or El Paso).

Richard C. Byrd, Ottawa, Kansas, Jeff Sharder, Amarillo, Texas, for Mesa Petroleum Company (or Mesa).

John Rosenberg and James L. Grimes, Topeka, Kansas, on behalf of Kansas Power and Light Company (or KP&L).

Ralph R. Brock, Wichita, Kansas, on behalf of Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum Inc.

William L. Robinson, Kansas City, Missouri, and Jack Glaves, Wichita, Kansas, on behalf of Panhandle Eastern Pipeline Company (or Panhandle).

Robert Martin, Timothy E. McKee, Wichita, Kansas, and Robert Miller, Denver, Colorado, on behalf of Kansas-Nebraska Natural Gas Company (or Kansas-Nebraska).

Patricia A. Gorham and Susan Ellis, Assistants General Counsel, on behalf of the Commission Staff and the public generally (of Staff).

An letter was submitted to the Commission on behalf of ARCO Oil and Gas Company in opposition to Staff's recommendations.

INTRODUCTION

This order concludes proceedings held before the Commission November 3 and 4, 1982, as a part of the general investigation into the provisions of the basic Proration Order for the Hugoton Gas Field. The issue addressed in these proceedings was whether or not changes should be made in the provisions of Paragraph (P) of the basic Proration Order with respect to over and under production from the field, specifically the issue concerning reinstatement of cancelled underage.

In its order of September 20, 1982, the Commission scheduled a hearing to begin November, 3, 1982, at the Wichita Royale, 125 N. Market, Wichita, Kansas. Staff was required to prefile testimony on or before October 6, 1982. All other parties were required to prefile testimony by October 20, 1982.

The following parties prefiled direct testimony: 1. Ron Cook, Consulting Petroleum Engineer on behalf of the Commission Staff. 2. William E. Feemster, Staff Gas Sales Representative, on behalf of Amoco Production Company. 3. Gary D. Hancock, General Manager of Supply, Production and Evaluation, on behalf of Northern Natural Gas Company. 4. Lester Wilkonson, Consulting Petroleum Engineer, on behalf of Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum Inc. 5. S. Javaid Anwar, Petroleum Engineer, on behalf of Cabot Petroleum. 6. Michael S. Daugherty, Manager of Acquisitions and Planning, on behalf of Mesa Petroleum. 7. Jimmy W. Mogg, Manager of Forecasting, on behalf of Panhandle Eastern Pipeline Company. 8. Robert McClure Danos, Senior Vice-President in charge of Gas Line Production, on behalf of Kansas-Nebraska Natural Gas Company, Incorporated. 9. Donald A. Hutton, Manager of Gas Supply Services, Kansas-Nebraska Natural Gas Company, Incorporated. Twenty-one exhibits were submitted in connection with the testimony.

At the close of testimony, Amoco Production Company requested leave to file a brief in support of its position on the issue of reinstatement of cancelled underage. The commission granted leave to file briefs not later than November 30, 1982. The deadline for filing briefs was later extended to December 10, 1982. Briefs were submitted on behalf of Mesa, Panhandle, Amoco, Northern Natural, Kansas-Nebraska, Cities Service Gas, and Colorado Interstate.

FINDING OF FACT AND CONCLUSIONS OF LAW

The Commission, being duly advised in the premises, and having given due consideration to the

record and files and all the evidence related thereto, makes the following findings and conclusions:

1. This Commission has been given jurisdiction to regulate the production of natural gas from a common source of supply in order to insure the orderly development of and production of natural gas pursuant to K.S.A. 1981 Supp. 55-703. Whenever the available production from the common source of supply is in excess of the market demand and the Commission has exercised its jurisdiction over the common source of supply, a producer is allowed to produce only a portion of the gas that may be produced without waste and to satisfy the market demand and to currently produce proportionately with other developed leases.

2. The Commission issued its basic order for the Hugoton Gas Field in Kearny, Finney, Grant, Haskell, Morton, Stevens, Seward, Stanton, Gray and Hamilton Counties, Kansas, on March 19, 1944, pursuant to its authority under Chapter 55 of the Kansas Statutes Annotated. As a part of the basic Proration Order for the Kansas Hugoton Field, a deliverability formula was established for use in assigning allowables to the wells producing from the Kansas Hugoton Field. To allow some flexibility to the producers in the field, the Commission established production tolerances for over and under production of the allowable as set by the Commission as part of the market demand proceedings. The tolerance provisions are set forth in Paragraph P of the basic order.

3. The order for a general investigation into the provisions of the basic Proration Order for the Kansas Hugoton Field was properly issued on March 15, 1982, pursuant to the Kansas Statutes. Notice of the November 3rd hearing was published in the Wichita

Eagle Beacon Newspaper at least ten days prior to the hearing as required by law. Notice was given to all known interested parties.

4. The issue addressed at this hearing concerns whether changes should be made in Paragraph (P) of the basic Proration Order for the Hugoton Gas Field as it relates to over and under production from the field.

5. Paragraph (P) provides: any well with an adjusted deliverability in excess of 300 Mcfd may accumulate overproduction or underproduction equivalent to six times the amount of the current allowable assigned to the well the preceding January before either being shut in due to excessive production or having the accumulated underproduction cancelled. Any well with an adjusted deliverability of less than 300 Mcfd may accumulate overproduction or underproduction equivalent to nine times the amount of current allowable assigned to the well for the preceding January before being shut in or having such accumulated underproduction cancelled. Any underage cancelled pursuant to the provisions of Paragraph (P) shall not be considered in determining the future production of a well unless otherwise determined by the Commission.

Paragraph (P) further provides: underages cancelled within the provisions of this paragraph will be reinstated upon verified application showing that the wells are in an overproduced status; that the purchaser is willing and able to take the amounts of gas sought to be reinstated; and that the length of time proposed by the applicant for the production of the amounts of gas to be reinstated is reasonable under the circumstances.

6. The Commission Staff made the following recommendations: (1) that the provisions of Paragraph (P) be amended to provide that any order reinstating cancelled

underage issued prior to January 1, 1983, remain in full force and effect. If a well is underproduced at the end of the time period set forth in the order, the remaining reinstated underage should be cancelled permanently. If the well is overproduced at the end of the time period set forth in the order up to a twelve month extension in which to make up the remaining reinstated underage may be granted by the Commission upon application to the Conservation Division.

(2) Effective January 1, 1983, any well which has underage cancelled prior to that date shall have that underage cancelled permanently unless an application to reinstate the underage is filed within two years or by January 1, 1985.

(3) After January 1, 1983, any well that has accumulated underproduction in excess of that amount allowed by the Hugoton basic order, shall have all underage cancelled. After all the underage is cancelled the well status will be zero and the well will again accumulate over/under production according to the provisions of the basic order. An operator shall have two years from the time the underage is cancelled to file an application to reinstate all or any part of the cancelled underage. If the Commission issues an order granting reinstatement and the well is underproduced at the end of the time period set froth in the order, the remaining reinstated underage shall be cancelled permanently. The operator shall have an opportunity to file an application and show cause why the underage should not be permanently cancelled. If the well is overproduced at the end of the time period set forth in the order an extension of twelve months in which to produce the cancelled underage may be granted by the Commission upon application to the Conservation Division.

(4) That any minimum allowable well which has

underage cancelled should be classified as a limited well. A limited well shall receive an allowable based on the well's actual adjusted deliverability rather than receiving the minimum allowable of 50 Mcfd. If the well has a zero deliverability, the well will be permitted to produce up to a maximum of 50 Mcfd until the well receives a calculated deliverability. Reinstatement of cancelled underage for a limited well should be granted under the same conditions as for any other well in the field.

Witnesses for Cabot Petroleum, Northern Pump Company, Graham-Michaelis and Kansas Petroleum opposed any change in the provisions of Paragraph (P) of the basic order. Witness Wilkonson recommended that all underage, both current and cancelled, be placed back on the monthly proration report to allow purchasers and other interested parties an opportunity to determine the true status of the field. Mr. Wilkonson testified that the only solution to the underage problem in the field is the production and taking of gas.

In Mr. Wilkonson's opinion, Staff's proposal would not provide an incentive for production. Mr. Wilkonson testified that to cause underage to be made up in too short a time would not permit the reservoir to function as it should. He recommended that a well should be permitted to make up cancelled underage over the same period of time as the cancellation occurred.

Mr. Wilkonson sponsored exhibits 8 and 9 for the purpose of showing the presence of drainage occurring from areas of high pressure (under produced wells) to areas of low pressure (wells currently producing their allowable). He testified that the permanent cancellation of underage would prohibit some wells from obtaining compensating drainage. He concluded that the permanent cancellation of underage would preclude the balancing of correlative rights.

Mr. Gary Hancock, witness for Northern Natural Gas recommended no change in Paragraph (P) of the basic Proration Order. The witness suggested instead that the monthly nominations be adjusted for prior months actual runs and used as the current allowable.

Witnesses for Kansas-Nebraska Natural Gas Company and Amoco Production Company recommended no change in the provisions of Paragraph (P).

Mr. Robert Danos and Donald Hutton testified on behalf of Kansas-Nebraska's position. Mr. Danos testified that the Staff's plan provided too short a period to allow Kansas-Nebraska to make up its underages. Mr. Hutton testified that in his opinion, the Staff's proposal would not allow Kansas-Nebraska wells an opportunity to produce their share of market requirements.

Panhandle Eastern Pipeline Company supported a change in the provisions of Paragraph (P). Panhandle's witness, Mr. Jimmy Mogg, testified that there is sufficient cancelled underage to cause concern whether correlative rights are being protected under current present reinstatement procedures. He testified that the success of proration depends upon the timely production of allowables. If operators are permitted to ignore allowables, there is no real proration in the field and correlative rights will be violated. The witness recommended that the effective date for changes in the Paragraph (P) of January 1, 1983, be deferred to no sooner than July 1, 1983, or until six months after the order becomes effective to allow purchasers to prepare for implementation. It was further recommended that the period for reinstating cancelled underage be extended to three years, and that an additional year extension be granted automatically if the well is in an overproduced status at the end of the time period. Mr. Mogg recommended that any overproduction should qualify an operator for

reinstatement. He recommended that all wells be treated the same rather than making a distinction with regard to wells with reinstatement orders before 1983 and those wells with reinstatement after 1983. Finally, it was recommended that if a minimum well category is to be put into effect, the category should apply only to those wells physically unable to produce 50 Mcf per day.

Mesa Petroleum's witness Mr. Michael S. Daugherty, testified in support of a change in the provisions of Paragraph (P) of the basic order. Mesa recommended that only one year be allowed for an operator to apply for reinstatement of cancelled underage for wells having underage cancelled after July 1, 1983. The witness further recommended that only one year instead of two years be allowed to make up reinstated underage. With these two exceptions Mesa Petroleum supported the recommendation made by Staff.

7. Since the basic Proration Order for the Kansas Hugoton Field was first issued in 1944, the Commission has from time to time amended the order with regard to the provisions relating to cancellation of underage in the field. The amendments have been necessitated by changes in field conditions and the market demand for natural gas produced from the field. The modification of the field rules is in keeping with the responsibility of this Commission to regulate the taking of natural gas to prevent inequitable or unfair taking of gas and prevent unreasonable discrimination in favor of or against any one producer in the field.

8. Arguments have been made by parties to the hearing that the Commission has no authority to permanently cancel underage because such cancellation may result in a violation of correlative rights which the Commission is mandated to protect. The Commission cannot agree. The correlative rights of a producer is the

right to participate in a given market for a given period of time. The delivery formula established to determine allowables in the field is designed to protect the rights of producers by assigning allowables to give them the opportunity to partipate in a given market. The record is clear that the parties agree that the existing deliverability formula is considered the best one possible for use in the field. The Commission's responsibility to protect correlative rights is fulfilled when operators are permitted to currently produce their assigned allowable. When an operator fails to produce that allowable over a period of time and the underage is accrued to the extent that it is in excess of that allowed by the provisions of the basic proration order, the Commission has authority to order such underage permanently cancelled.

The Commission finds that the problem with correlative rights violations does not result from the assignment of the allowable but rather from the failure of producers and pipelines to take production from the field. Currently, Paragraph P of the Proration Order gives producers an adequate opportunity to produce their allowables on a timely basis. Those operators producing their allowable may have wells with lower pressures than the average wells in the field and consequently may receive a smaller allowable than those operators not producing their allowables. The lack of incentive to produce afforded by the extreme tolerance provisions of the Proration Order results in depriving some operators of the opportunity to participate in the given market. Since the Commission has the responsibility to prevent unreasonably discrimination against any one producer in the field, the Commission has the responsibility to correct this situation. It is the purpose of this order not to restrict production of gas but to encourage it.

The evidence clearly demonstrates that Paragraph

P does not provide operators sufficient incentive to produce gas. Ron Cook testified that as of September 1, 1982, the current underage in the field was 204.5 Bcf as compared to 144.5 Bcf on September 1, 1981. There has been over 508 Bcf of underage cancelled from January 1, 1967 to August 1, 1982, with only 194 Bcf of underage reinstated during that period.

9. Having addressed the evidence related to correlative rights violations, the additional evidence introduced is interpreted by the Commission to relate to two general issues:

(1) Will Staff's plan provide an incentive to operators to produce their allowables; and,

(2) Is there a better plan to encourage production of current allowables than presented by Staff.

Within these confines, the issue presented in this docket becomes clear: upon the evidence presented in this proceeding, what is the best method to encourage ratable taking of assigned allowables?

The Commission is persuaded that an incentive for operators to produce is created by tightening the provisions of the basic order with regard to the cancellation of underage. However, any change in policy should include a reasonable opportunity to reinstate and produce cancelled underage before such underage is permanently cancelled. The general support of Staff's plan by Mesa and Panhandle evidence the fact that limiting the period under which underage may be reinstated and produced may induce production in the field. As Mesa notes in its brief, that the plan will be an inducement for increased production is also evidenced by some producer's objections to the changes proposed.

The Commission is not persuaded by the comments of witnesses, such as Lester Wilkonson, that the Staff

proposal to tighten the cancellation policy will solve the underproduction problem only on paper. The Commission finds that while the adoption of a stricter policy regarding cancelled underage is not guaranteed to increase production, the existing situation in the field warrants all reasonable efforts to do so.

The Commission finds that adjusting monthly nominations for prior actual runs will compound the violation of correlative rights of those producers who wish to produce their current allowable. Adjusting monthly nominations for prior runs would cause allowables to be adjusted downward. In effect, the adjustment would diminish the right of some producers to participate in the current market, thus violating their correlative rights. For this reason, the proposal of Northern Natural Gas is rejected.

Similarly, the proposals of Kansas-Nebraska Natural Gas Company and Amoco Production Company are rejected, as these companies recommended no changes in the provisions of Paragraph P. Mr. Wilkonson and others testified that the only solution to the problem in the field is the production and taking of gas by the pipelines. It is clear that, under the present provisions, production is not adequately occurring and underages are accumulating. Therefore, some change is necessary. The evidence sponsored by staff, Mesa Petroleum and others demonstrate that the current provisions do not induce the production necessary to balance the field and protect correlative rights.

The Commission finds it is in the public interest to allow operators a reasonable period in which to reinstate and make up cancelled underage. This period must be reasonable while it cannot be so long as to endanger the correlative rights of those producers who have consistently produced their allowables, and it cannot be so

short as to cause waste. The Commission notes that the evidence presented in respect to time restraints for production of underage runs the range from no time limit whatsoever to produce underage to a one year limitation. The Commission feels that between these two proposals exists a reasonable time period in which cancelled underage must be reinstated and produced.

10. It is estimated that as of September 1982 there was approximately 314 Bcf of cancelled underage in the field. As indicated by the evidence, this underage dates back at least to the 1960's. The testimony of Mr. Hancock, Mr. Feemster, Mr. Anwar and Mr. Danos shows that individual wells in the field have suffered underage cancellation prior to 1970. The Commission believes it is in the public interest and in the interest of the producers to clear up this underage dilemma as much as possible. In the future, it will be practically impossible to ascertain the balance of the field if underages relate backward in perpetuity. Some sort of benchmark is necessary if the Commission is to effectively balance takes from the field. Given the current high volume of cancelled underage, the Commission finds that it is doubtful that much of the underage cancelled prior to 1975 will be able to be produced. Moreover, the Commission notes that the evidence shows that during 1974, cancelled underage in the field was at its lowest level relative to other years. Further, the Commission notes that prior to 1975, large volumes of cancelled underage were reinstated. Therefore, the Commission finds that January 1, 1975 would be a reasonable benchmark from which to address old underage. The Commission does however wish to give the operators ample opportunity to reinstate and produce as much of this old underage as is possible. For these reasons, the Commission finds that for underage cancelled prior to January 1, 1975, an operator may request that the Commission reinstate all or any portion of such cancelled underage up to December 31, 1983. The request for reinstatement of this underage shall not be contingent upon the well being in an overproduced status. Any underage cancelled prior to January 1, 1975 for which reinstatement is not requested by the December 31, 1983 date, shall be permanently cancelled.

Underage cancelled during the period of January 1, 1975 through December 31, 1982 may be reinstated if the operator requests such reinstatement prior to December 31, 1985. Provided, however, the well shall be in an overproduced status at the time the request for reinstatement is made. This is in keeping with past Commission policy regarding reinstatement of underage. The operator shall be allowed up to 60 months in which to produce any reinstated underage. Any underage not requested to be reinstated by the December 31, 1985 date shall be cancelled permanently.

For underage cancelled after December 31, 1982, an operator shall have three years from the date of cancellation in which to request reinstatement. The well for which reinstatement is requested shall be in an overproduced status at the time the application for reinstatement is filed. Any reinstatment underage not produced at the end of the time period set forth in the Commission's order shall be cancelled permanently.

All applications for reinstatement shall state (1) that the well is physically capable of producing the reinstated underage in addition to the current allowable, (2) the length of time requested to make up the reinstated underage, which in no event shall be more than 60 months, (3) that the purchaser is ready and willing to take the additional gas, and (4) the month, year and volumes of underage cancelled.

Upon the filing of an application and a showing of

the existence of exceptional circumstances such as an act of God, the Commission may order the underage not be permanently cancelled.

11. Any existing orders of this commission reinstating cancelled underage and allowing certain time periods for the production of such reinstated underage shall remain in full force and effect as set forth in such order. If the underage requested to be reinstated is not produced by the end of the time period allowed for production as set forth in the order, such underage shall be permanently cancelled.

12. As a part of its recommendations to the Commission, staff proposed that a limited well category be included in the provisions of the basic Proration Order. The limited wells would consist of those wells which receive a minimum allowable and have had underage cancelled. It was Staff's position that this category would set the allowables for such wells at a more realistic rate and prevent additional cancelled underage. While the Commission finds that such a category may benefit those wells and the field as a whole, we find that the category should not be adopted at this time. The inclusion of such category in the basic Proration Order would require further investigation and review by this Commission.

13. The Commission finds that it is in the interest of the purchasers, operators and the general public to provide additional information as to the status of the wells producing from the Kansas Hugoton Field. The Commmission Staff is hereby directed to annually publish the status of all wells in the field setting forth the total underage cancelled, the underage reinstated, and reinstated underage still to be produced, as well as other pertinent information presently included in the Commission's report. This report shall indicate the

status of all wells as of December 31 of the year for which it is issued. The initial report shall be prepared and published by Staff no later than May 1, 1983.

It is, therefore by the Commission ordered:

That Paragraph (P) of the basic Proration Order for the Kansas Hugoton Field be and the same is hereby amended as follows:

For underage cancelled prior to January 1, 1975, an operator shall be allowed to request reinstatement of all or a portion of such underage any time up to December 31, 1983. The well shall not be required to be in an overproduced status to have underage reinstated. Any underage that is reinstated and not produce within the specified time limit shall be permanently cancelled.

For underage cancelled between January 1, 1975 and December 31, 1982, an operator shall be allowed to request reinstatement at any time prior to December 31, 1985. At the time an application for reinstatement is filed the well shall be in an overproduced status. Any underage not reinstated or which has been reinstated and not produced according to these prescribed time limits, shall be cancelled permanently.

For underage cancelled after December 31, 1982, an operator shall have three (3) years from the date of cancellation to request reinstatement of such underage. The well must be in an overproduced status in order for an operator to request reinstatement. Any cancelled underage not reinstated or which has been reinstated and not produced shall be cancelled permanently.

All applications for reinstatement shall state (1) that the well is physically capable of producing the reinstated underage in addition to the current allowable, (2) the length of time requested to make up the reinstated underage, which in no event shall be more than

60 months, (3) that the purchaser is ready and willing to take the additional gas, and (4) the month, year, and volumes of underage cancelled.

Upon the filing of an application and a showing of the existence of exceptional circumstances such as an act of God, the Commission may order that underage not be permanently cancelled.

The Staff is directed to annually publish the over/under status of all the wells in the Hugoton Field beginning with the status as of December 31, 1982. The initial report shall be published no later than May 1, 1983.

The Commission retains jurisdiction over the subject matter and the parties for the purpose of entering such further order or orders as may be deemed necessary.

Dated: February 16, 1983

Loux, Chmn.; Roy, Com.; Dick, Com.

Acting Executive Secretary

APPENDIX E

Docket No. C-164

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS

CONSERVATION DIVISION

BEFORE COMMISSIONERS: RICHARD C. (PETE) LOUX, Chairman, JANE T. ROY, PHILLIP R. DICK

IN THE MATTER OF ESTABLISHING RULES AND REGULATIONS RELATING TO THE PRODUCTION, SALE, AND CONSERVATION OF NATURAL GAS IN THE HUGOTON FIELD IN KEARNY, FINNEY, GRANT, HASKELL, MORTON, STEVENS, SEWARD, STANTON, GRAY, AND HAMILTON COUNTIES, KANSAS.

ORDER

NOW, the above captioned matter comes on for consideration and determination by the State Corporation Commission of the State of Kansas before Commissioners; Richard C. (Pete) Loux, Chairman; Jane T. Roy; and Phillip R. Dick.

Applications for a rehearing of the Commission's order issued in this docket, February 16, 1983, were filed on behalf of Kansas-Nebraska Natural Gas Company, Inc., Amoco Production Company, Northern Natural Gas Company, Division of Internorth, Inc., Colorado Interstate Gas Company, Panhandle Eastern Pipe Line Company, and Northwest Central Pipeline Corporatin.

The Commission, by order dated, March 4, 1983, granted the applications and scheduled a rehearing for March 17, 1983, at 2:00 p.m., at the Wichita Royale, 125 N. Market, Wichita, Kansas, for the purpose of receiving oral argument only on the issues set forth in the

applications. Notice of the rehearing was mailed to all interested parties as shown on the Commission's mailing list in this docket.

Rehearing was held pursuant to the notice. The following appearances were made:

Mark H. Adams, Jr., Wichita, Kansas, and John Cary, Oklahoma City, Oklahoma, for Northwest Central Pipeline Company (Northwest Central).

Mark H. Adams, Jr., Wichita, Kansas, and Patrick McCarthy, Omaha, Nebraska, for Northern Natural Gas Company (Northern Natural).

Glenn D. Young, Wichita, Kansas, and Robert Leo, Dener, Colorado, on behalf of Amoco Production Company (Amoco).

Timothy McKee, Wichita, Kansas, and Kim Cocklin, Colorado Springs, Colorado, on behalf of Colorado Interstate Gas Company (CIG).

Timothy McKee, Wichita, Kansas, and Robert Miller, Lakewood, Colorado, on behalf of Kansas-Nebraska Natural Gas Company, Inc. (Kansas-Nebraska).

Jack Glaves, Wichita, Kansas, and William L. Robinson, Kansas City, Missouri, on behalf of Panhandle Eastern Pipe Line Company (Panhandle).

Richard C. Byrd, Ottawa, Kansas, on behalf of Mesa Petroleum Corporation (Mesa).

Ralph Brock, Wichita, Kansas, on behalf of Cabot Petroleum, Northern Pump Corporation, Graham-Michaelis Corporation, and Kansas Petroleum, Inc., (Cabot, et al).

John Rosenberg, Topeka, Kansas, on behalf of Kansas Power and Light Company (KPL).

Jerome E. Jones, Wichita, Kansas, on behalf of Mobil Oil Corporation (Mobil) and Northern Natural

Gas Producing Company (Northern Natural Gas).

Stanford Smith, and Stanford Smith, Jr., Wichita, Kansas, on behalf of Cities Service Company (Cities).

Greg Stucky, Wichita, Kansas, on behalf of the Southwest Kansas Royalty Owners Association.

Patricia A. Gorham, Assistant General Counsel, on behalf of the Commission Staff and the Public generally (Staff).

INTRODUCTION

The applications for rehearing filed in this docket concern the Commission's order issued February 16th relating to the provisions of Paragraph (P) of the basic Proration Order for the Kansas Hugoton Field. The various applications for rehearing allege that the Commission's order is unreasonable and unlawful and that the order should be set aside. The allegations raised in the applications for rehearing can be summarized as follows:

That the Commission's order is unreasonable in that it failed to consider all the evidence in the record;

That the Commission's order is unlawful because the Commission fails to carry out its responsibility to prevent waste and protect correlative rights;

That the Commission exceeded its authority with respect to the protection of correlative rights and the prevention of waste;

That the Commission's order violates the U.S. Constitution and the Kansas Bill of Rights;

That the Commission's order is an impermissible attempt to regulate the natural gas pipelines which are under the sole jurisdiction of the FERC;

That the Commission's order amounts to retroactive rule making;

And finally that with respect to existing reinstatement orders the Commission's order is discriminatory in failing to allow additional time for making up reinstated underage in keeping with the other provisions of Paragraph (P).

The Commission having heard the arguments of the parties and after giving due consideration to the records and its files, makes the following findings and conclusions:

1. The Commission has jurisdiction to regulate the production of natural gas from a common source of supply under the provisions of K.S.A. 1981 Supp. 55-703. Pursuant to this jurisdiction, the Commission issued the basic Proration Order for the Kansas Hugoton Field in Docket No. C-164.

2. The Commission entered its order amending the provisions of Paragraph (P) of the basic Proration Order in this docket dated February 16, 1983.

3. Applications requesting rehearing of the Commission's order issued February 16, 1983, were filed on behalf of Northwest Central Pipeline Corporation, Colorado Interstate Gas Company, Amoco Production Company, Panhandle Eastern Pipe Line Company, Kansas-Nebraska Natural Gas Company and Northern Natural Gas. The applications for rehearing were timely filed pursuant to Kansas statutes and the regulations of this Commission.

4. By order issued March 4, 1983, the Commission granted the applications for rehearing. Rehearing was set for March 17, 1983, at the Wichita Royale, 125 N. Market, Wichita, Kansas, at 2:00 p.m. for purposes of oral argument only. Notice of the rehearing was mailed to all interested parties as required by law.

Applicant Northwest Central questioned the Commission's authority to allow oral arguments only on an application for rehearing. The Commission's rules of practice and procedure apply to rehearings before the Commission and are applicable to actions brought under the conservation statutes. K.A.R. 82-1-235(C) specifies four different types of rehearings that may be had before the Commission. K.A.R.82-1-235(C)(3) provides for rehearing for oral argument. The Commission's procedure in this instance is clearly within its jurisdiction.

5. As a part of its application for rehearing, Northwest Central requested that certain exhibits be admitted into the record of this docket. The motion was objected to by Staff. After hearing arguments on the motion, the Commission took the motion under advisement. The Commission finds that the subject exhibits do not provide the commission with additional relevant information not previously presented. The request to be allowed to submit additional exhibits is denied.

6. The Commission has carefully reviewed and considered the contentions raised by the applications for rehearing as well as the oral arguments presented at the hearing. We are of the opinion that the order of February 16, 1983, should be affirmed with one exception.

Panhandle, Amoco, and Cities argued on rehearing that Paragraph (11) of the Commission's February 16th order, which pertains to existing orders reinstating cancelled underage, is unreasonable and discriminatory. These parties argued that under the February 16 order underage subject to a reinstatement order issued prior to February 16, 1983, is not treated equal to underage not previously reinstated. Paragraph (11) does not allow any additional time in which to produce reinstated underage other than that time set forth in the existing order.

The Commission feels that the parties make a valid objection with regard to Paragraph (11). As stated in the order, it is the Commission's intent to allow a reasonable amount of time for making up cancelled underage in the field. For all other underage, subject to compliance with the Commission's requirements, up to 60 months may be allowed in which to produce reinstated underage. It is not unreasonable to provide a similar time period for underage presently reinstated by order of the Commission.

The Commission finds that any operator with an existing order allowing reinstatement of cancelled underage may make application to the Commission for an extension of time in which to produce the reinstated underage. The additional time requested shall in no event exceed 60 months. The application for an extension of time shall state that the well is physically capable of producing the remaining underage in addition to the current allowable, the amount of reinstated underage remaining to be produced, that the purchaser continues to be able to take the additional gas, and the amount of additional time requested to produce the reinstated underage.

7. The pipeline purchasers, with the exception of Panhandle and KPL, contend that the Commission lacks the authority to amend Paragraph (P) of the basic order so as to limit the time period in which cancelled underages must be reinstated and produced. The principal arguments advanced relate to the Commission's lack of, or misinterpretation of, the authority granted to it in K.S.A. 55-703, the unlawful invasion of the authority of the FERC under the Natural Gas Act and that the order violates the correlative rights of the producers.

8. The contention that the Commission's order of

February 16, 1983, changing the provisions of Paragraph (P) of the Hugoton basic order invades the exclusive jurisdiction of the FERC under the Natural Gas Act is without merit. The Hugoton basic order Paragraph (P) as amended is a gas conservation order prescribing field rules for the producers of gas from the field. The February 16 order is directed to and affects only those who drill for and produce gas from the Hugoton Field. The purpose of the basic order is to prevent waste, protect the correlative rights of mineral interests owners and promote the orderly development of the field, functions clearly reserved to the states under the production exemption of the Natural Gas Act. The February 16th order does not require pipelines purchasers to do anything or refrain from doing anything. The order permits the reinstatement of cancelled underages and the production of the underages reinstated if applications are timely filed and the gas timely produced. The obligations imposed to file applications for reinstatement of cancelled underages is on the producers, not the purchasers. The instant order is clearly distinguishable from the order considered by the United States Supreme Court in *Northern Natural Gas Company v. State Corporation Commission*, 372 U.S. 84 (1962).

9. The authority of this Commission under K.S.A. 1982 Supp. 55-703 relating to the reinstating of cancelled underages has been previously challenged and determined by the Kansas Supreme Court. The Court in the *Republic Natural Gas Company v. State Corporation Commission*, 173 Kan. 172 (1953), affirmed this Commission's actions in refusing to reinstate underages cancelled pursuant to Paragraph (P) of the basic proration. The underages which the court said the Commission was correct in not reinstating in the *Republic* case, were underages that were in excess of three times a well's

current allowable. The Commission, in its order of February 16, permits applications to be filed requesting reinstatement of underages in excess of six times the current January allowable. The order permits these applications to be filed until December 31, 1983, for underages cancelled prior to January 1, 1975; until December 3, 1985, for underages cancelled between January 1, 1975 and December 31, 1982; and a full three years for underages cancelled after December 31, 1982. Surely, if the Commission has authority under the statute to refuse to reinstate cancelled underages as the Court found in the *Republic* case, the Commission has the authority to limit the time within which applications must be filed and underages reinstated must be produced.

10. Some of the applicants for rehearing contend that the February 16 order is unreasonable because it disregarded the weight of the evidence in relying on Staff's evidence and testimony. This allegation completely disregards the fact that the Commission did not adopt the Staff's recommendations. The Commission made specific findings of fact based on the record. The Commission's order is predicated upon a review of all the testimony in the record and therefore reasonable and proper.

11. The Commission does not interpret the provisions of 55-703 as limiting the Commission's jurisdiction to placing restrictions upon the amount of gas to be produced from a common reservoir. The determination of the market demand from the Hugoton Field and the assignment of permissive allowables permitting the production of that market demand is only part of the Commission's obligations under the conservation statute. The prescribing of reasonable periods of time in which those allowables must be produced is as important as

the assignment of the allowables in the first instance. As the Supreme Court stated in the *Republic* case, "By the very nature of the business of conserving the gas supply, the time element must be considered." The legislature recognized this when it provided: "Then any person, firm or corporation having the right to produce natural gas therefrom, may produce only such portion of all the natural gas that may be currently produced without waste and to satisfy the market demands, —." 'Currently' as used in the above, logically refers to some period of time. The Commission has the authority to make a determination as to what reasonable time limitations should be implemented in the field. The Commission's order of February 16 does set forth reasonable time limitations for the reinstatement and production of cancelled underage from the field in keeping with its authority.

12. The contention of certain producers that the order of February 16 will violate their correlative rights is predicated. Upon the fact that allowables once assigned, if not ultimately permitted to be produced, prevents that producer from producing approximately the amount of gas underlying its lease. This argument overlooks the fact that allowables are permissive not mandatory by nature. The Commission cannot make a producer produce its current allowable. The Commission must, and has according to the record, assigned allowables to the various wells in the field that will permit them, if produced, to recover approximately the amount of gas underlying their lease. The obligation on the Commission to assign allowables and regulate the production of gas in a manner that will ultimately let each producer recover approximately the amount of gas underlying the lease must be balanced with the obligation of the Commission to permit each producer to produce only such portion of all the natural gas that may

be currently produced without waste and that will satisfy the market demands. As the Supreme Court of Kansas stated in the *Republic* case, "'The market in which the producer has the right to participate is a 'given market.' It is the current market upon which each month's allowable is based. The Commission's order will not cause the violation of correlative rights.

13. The contention is made by certain parties requesting modifications in the Commission's February 16 order, that the order could ultimately cause waste of the natural gas by requiring the reinstated underages to be produced at a rate that could cause damage to the reservoir. This concern, of course, could be alleviated by determination by the Commission that cancelled underages should not be permitted to be produced and once cancelled be permanently cancelled. The Commission, however, does not find that the allegations that the reinstatement order would cause waste justify altering its original order in this proceeding. The testimony of Mr. Wilkonson in this regard was speculative and was predicated upon the Commission's adopting the time restraints recommended by the Staff. As previously stated, the Commission did not adopt the Staff recommendations. The most limiting restraint placed upon the reinstatement and production of cancelled underages relates to underages cancelled prior to January 1, 1975. Applications must be filed by December 31, 1983, and the time for which these underages may be produced is discretionary with the Commission, but a period not in excess of five years. The record does not indicate the volume of gas that is subject to reinstatement under this provision in the order, but with the volume of gas not known, it is purely speculative that the production of such volumes in addition to the current allowables to be fixed by the Commission during the ensuing period

could cause physical damage to the reservoir. The allowables cancelled after January 1, 1975, and cancelled in the future will have approximately three years before applications for reinstatement have to be filed and another five years in which those underages can be produced. There is no evidence in the record that would indicate the reinstatement and production of underages over this period of time would in any way damage the wells or the reservoir.

14. It is argued that the Commission's February 16th order constitutes retroactive rule making. It is difficult to understand the basis for this argument. It has been pointed out numerous times that this Commission has amended various provisions of the Hugoton basic order, including Paragraph (P) to meet the changing conditions in the field. Such changes have been upheld by the courts as being within the Commission's authority. In issuing the February 16th order, the Commission is once again making amendments to its order to address the current situation in the field. Such action by the Commission was and continues to be proper.

15. The Commission's order of February 16, is in accordance with its statutory mandates and does not invade the jurisdiction of the FERC. The order is based on substantial competent evidence and is therefore reasonable and proper.

It is, therefore, by the Commission ordered that its order of February 16, 1983, with the exception of Paragraph (11) be and the same is hereby affirmed.

The Provisions of Paragraph (11) are hereby modified as set forth in finding (6) above.

The Commission retains jurisdiction over the subject matter and the parties for the purpose of entering

such further order or orders as from time to time it may deep proper.

Loux, Chmn.; Roy, Com.: Dick, Com.

Dated April 18, 1983

Judith McConnell
Executive Secretary

APPENDIX F

SUPREME COURT,
STATE OF KANSAS, } ss. Dist. Court No. 83C20, 21, 22, 83C23, 24 No. 84-56917-S

The State of Kansas, to the District Court within and for the County of Gray in the State of Kansas, Greeting:

WHEREAS, In a certain civil, ~~criminal~~ action lately pending before you, wherein

Northern Natural Gas Company, et al plaintiff

and

The State Corporation Commission defendant

a judgment was rendered by you against the said Plaintiffs

from which judgment said Plaintiffs

prosecuted an appeal in the Supreme Court within and for the State of Kansas;

AND WHEREAS, at the December Session of the 1986 July Term of said Supreme Court, A. D. 19 86, on consideration of the said appeal it was ordered and adjudged by the said Supreme Court that the judgment of the District Court be Affirmed, attested true copy opinion attached

and that the said recover against the said Dollars for costs herein expended and have execution therefor.

YOU ARE THEREFORE COMMANDED, That without delay you cause execution to be had of the said judgment of the Supreme Court, according to law.

APP 1 3 1987
LEGAL DIVISION

APR 1987
RECEIVED

MANDATE RECEIVED BY CLERK
TRIAL JUDGE NOTIFIED Date:

Costs
Fees of Clerk Supreme Court
Record
Transcript
Other costs
Total

FILED
87 MAR 25 AM 10:28
CLERK DISTRICT COURT
PRATT COUNTY, KANSAS

WITNESS my hand and the seal of said Supreme Court affixed hereto, at my office, in the City of Topeka, on the MAR 20 1987 day of A. D. 19

Lewis C Carter
LEWIS C. CARTER, *Clerk of the Supreme Court.*

APPENDIX G

IN THE SUPREME COURT OF THE STATE OF KANSAS

Case No. 84-56,917

NORTHWEST CENTRAL PIPELINE CORPORATION, KN ENERGY, INC.; AMOCO PRODUCTION COMPANY; and COLORADO INTERSTATE GAS COMPANY,
Appellants,

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, et al.,
Appellees.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Williams Natural Gas Company, formerly Northwest Central Pipeline Corporation, appellant in the above-styled action, hereby appeals to the Supreme Court of the United States from the final Order and Judgment of this Court, entered February 20, 1987, on remand from the United States Supreme Court, approving the Order of the State Corporation Commission of the State of Kansas in Docket C-164, amending Paragraph (p) of the Basic Proration Order for the Kansas Hugoton Gas Field and distinguishing *Transcontinental Pipe Line v. Oil & Gas Bd.*, 474 U.S. ____, 88 L.ed 2d 732 (1986); and although admitting that the state regulation would incidentally affect the cost of gas, holding that Paragraph (p) of the Basic Order for the Kansas Hugoton Field, as amended, does not improperly interfere with exclusive federal

regulation of the interstate transportation and sale of natural gas, because it is directed to gas producers rather than purchasers, and comes within the Kansas Commission's statutory authority to prorate and control production to prevent economic and physical waste and to protect correlative rights between producers in the Kansas Hugoton Gas Field and those in the Oklahoma and Texas Hugoton Fields.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

Dated this 25th day of March, 1987.

Respectfully submitted,

WILLIAMS NATURAL GAS COMPANY

John Cary
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Tulsa, OK 74102

Mark H. Adams, II
Kay Gowen
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P.O. Box 273
Wichita, KS 67201

By_____
Mark H. Adams, II

Attorneys for Williams Natural Gas Company

CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing Notice of Appeal to the Supreme Court of the United States was mailed, postage prepaid, on the 25th day of March, 1987, to those persons shown below.

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APPENDIX H

FEDERAL CONSTITUTIONAL AND STATUTORY PROVISIONS

The Commerce Clause of the Constitution, U.S. Const. art. I, § 8, cl. 3:

> The Congress shall have power . . . to regulate commerce with foreign Nations, and among the several states, and with the Indian Tribes . . . .

The Supremacy Clause of the Constitution, U.S. Const. art. VI, cl. 2:

> SUPREME LAW OF LAND
>
> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 1 (b) of the Natural Gas Act, 15 U.S.C. § 717 (b):

> (b) The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation for sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 601 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3431:

> COORDINATION WITH NATURAL GAS ACT
>
> (a) Jurisdiction of Commission under Natural Gas Act. —
>
> (1) Sales. —
>
> (A) *Natural gas not committed or dedicated.* — For purposes of section 1(b) of the Natural Gas Act, effective on the first day of the first month beginning after November 9, 1978, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of November 8, 1978, solely by reason of any first sale of such natural gas.
>
> (B) *Committed or dedicated natural gas.* — Effective beginning on the first day of the first month beginning after November 9, 1978, for purposes of section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of November 8, 1978, and which is —
>
> (i) high-cost natural gas (as defined in section 3317 (c), (1), (2), (3), or (4) of this title);
>
> (ii) new natural gas (as defined in section 3312 (c) of this title); or
>
> (iii) natural gas produced from any new, onshore production well (as defined in section 3313 (c) of this title).
>
> (C) *Authorized sales or assignments.* — For purposes of section 1 (b) of the Natural Gas

Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply by reason of any sale of natural gas —

(i) authorized under section 3362 (a) or 3371 (b) of this title; or

(ii) pursuant to any assigned authorized under section 3371 (a) of this title.

(D) *Natural-gas company.* —
For purposes of the Natural Gas Act, the term "natural-gas company" (as defined in section 2 (6) of such Act) shall not include any person by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

(E) *Alaskan natural gas.* —
Subparagraph (B) (ii) and (iii) shall not apply with respect to natural gas produced from the Prudhoe Bay unit of Alaska and transported through the transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

(2) Transportation. —

(A) *Jursidiction of the Commission.*
For purposes of section 1 (b) of the Natural Gas Act the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply to any transportation in interstate commerce of natural gas if such transportation is —

(i) pursuant to any order under section 3362 (c) or section 3363 (b), (c), (d), or (h) of this title; or

(ii) authorized by the Commission under section 3371 (a) of this title.

(B) *Natural-gas company.*
For purposes of the Natural Gas Act, the term "natural-gas company" (as defined in section 2 (6) of such Act) shall not include any person by reason of, or with respect to, any transportation of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission under the Natural Gas Act do not apply to such transportation by reason of subparagraph (A) of this paragraph.

(b) Charges deemed just and reasonable.

(1) Sales.

(A) *First sales.* Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act, any amountg paid in any first sale of natural gas shall be deemed to be just and reasonable if —

(i) such amount does not exceed the applicable maximum lawful price established under sub-chapter I of this chapter; or

(ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to part B of subchapter I of this chapter.

(B) *Emergency sales.* For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any sale authorized under section 3361 (a) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established under such section and applicable to such sale.

(C) *Sales by intrastate pipelines.* For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any sale authorized by the Commission under section 3371 (b) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established by the Commission and applicable to such sale.

(D) *Assignments.* For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid pursuant to the terms of any contract with respect to that portion of which the Commission was authorized an assignment authorized under section 3372 (a) of this title shall be deemed to be just amd reasonable if such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter.

(E) *Affiliated entitles limitation.* For purposes of paragraph (a), in the case of any first sale between any interstate pipeline and any affiliate of such pipeline, any amount paid in any first sale shall be deemed to be just and reasonable if, in addition to satisfying the requirements of such paragraph, such amount does not exceed the amount paid in comparable first sales between persons not affiliated with such interstate pipeline.

(2) Other charges. —

(A) *Allocation.* — For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for transportation, storage, delivery or other services provided pursuant to any order under section 3363 (b), (c), or (d) of this title shall be deemed to be just and reasonable if such amount is prescribed by the

President under Section 3363 (h) (1) of this title.

(B) *Transportation.* — For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for any transportation authorized by the Commission under section 3371 (a) of this title shall be deemed to be just and reasonable if such amount does not exceed that approved by the Commission under such section.

(c) Guaranteed passthrough.

(1) *Certificate may not be denied based upon price.* — The Commission may not deny, or condition the grant of, any certificate under section 7 of the Natural Gas Act based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable under subsection (b) of this section.

(2) *Recovery of just and reasonable prices paid.* — For purposes of sections 4 and 5 of the Natural Gas Act, the Commission may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if —

(A) under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act, and

(B) such recovery is not inconsistent with any requirement of any rule under section 3341 of this title (including any amendment under section 3342 of this title),

except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.

Section 602 of the NGPA, 15 U.S.C. § 3432:

EFFECT ON STATE LAWS

(a) *Authority to prescribe lower maximum lawful prices.* — Nothing in this chapter shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under subchapter I of this chapter.

(b) *Common carriers.* — No person shall be subject to regulation as a common carrier under any provision of Federal or State law by reason of any transportation —

(1) pursuant to any order under section 3362 (c) or section 3363 (b), (c), (d), or (i) of this title; or

(2) authorized by the Commission under section 3371 (a) of this title.

APPENDIX I

STATE STATUTES AND REGULATIONS

Kansas Statutes

K.S.A. 55-601. *Waste Prohibited.* The production of crude oil or petroleum in the state of Kansas in such manner and under such conditions as to constitute waste is hereby prohibited and shall be unlawful.

K.S.A. 55-602. *Waste defined; rules and regulations; person defined.* The term "waste" as used herein, in addition to its ordinary meaning, shall include economic waste, underground waste, surface waste, waste of reservoir energy, and the production of crude oil or petroleum in excess of transportation or marketing facilities or reasonable market demands. The state corporation commission shall have authority to make rules and regulations for the prevention of such waste and for the protection of all fresh-water strata, and oil-and gas-bearing strata encountered in any well drilled for, or producing, oil. "Person" as herein used shall mean any natural person, corporation, association, partnership, receiver, trustee, guardian, executor, administrator and a fiduciary of any kind.

K.S.A. 55-603. *Production regulated; temporary bonus or discovery allowables to wells in new oil common sources of supply; prevention of unreasonable discrimination.* Whenever the full production from any common source of supply, herein called "pool" of crude oil in this state can only be obtained under conditions (a) constituting waste as herein defined, or (b) independently of waste, under conditions injurious to the respective correlative rights of the producers therein, or (c) under conditions unreasonably discriminating against other pools in the

state, then any person having the right to drill into and produce oil therefrom may take therefrom currently no more than that proportion of all crude oil which may be produced therefrom, currently without waste, or without such injury, or without such discrimination, which the productivity of his or her well or wells considered in connection with the acreage reasonably attributable to each thereof bears to the productivity of all the wells therein considered in connection with the acreage reasonably attributable to each thereof: *Provided, however,* That the commission may after notice and hearing, grant a temporary bonus or discovery allowables, in addition to normal allowables, to oil wells which are completed in and which produce from any new and separate oil common source of supply, as determined by the commission. Any temporary bonus or discovery allowable so granted may be modified, reduced or discontinued by the commission at any time after due notice has been given to all interested parties. The state corporation commission is authorized and it shall be its duty, to so regulate the taking of crude oil from any pool within the state of Kansas as to prevent waste therein or, independently of waste, to prevent unreasonable discrimination therein; and said commission is further authorized, and it shall be its duty, to prevent unreasonable discrimination in favor of any one pool as against any other pool or pools in this state in the allocation of allowable production among such pools.

K.S.A. 55-604. *Rules and regulations; agents; powers of commission; acreage adjustment, when.*

(A) The commission shall have and is hereby given jurisdiction and authority over all matters involving the application and enforcement of this act,

and shall have authority to make and enforce rules, regulations and orders for the prevention of waste as herein defined and for carrying out and enforcing each and all of the provisions of this act; and the commission shall have authority to make and enforce rules, regulations and orders which provide for the granting of temporary bonus or discovery allowables, in addition to normal allowables, to oil wells which are completed in and which produce from any new and separate oil common source of supply as determined by the commission and which provide for the modification, reduction or discontinuance of such temporary bonus or discovery allowables at any time, and it is authorized to employ or appoint such agent or agents as may be necessary to enforce and administer the provisions of this act, and its rules, regulations and orders; such agent or agents, with the exception of clerical help, to be a person or persons experienced in and conversant with the oil business; and, without limiting the generality of the foregoing powers and duties, the commission shall have the further power and authority hereinafter set forth.

(B) The commission shall determine the reasonable market demand for crude oil produced in this state and shall allocate among the pools in the state the amount of oil that may be produced therein without waste, impairment of correlative rights and unreasonable discrimination between pools. In making such determinations of the reasonable market demand the commission shall take into consideration, among other proper factors, and give due and proper weight to the following:

(a) The estimated consumer demand;

(b) offers to purchase and the good faith thereof;

(c) the price or prices offered in relation to the prevailing price of crude oil generally in the state: *Provided*, That nothing contained in this section is intended to vest the commission with authority to fix the price of crude oil but such limitation shall not affect the authority of the commission prescribed under K.S.A. 55-612; and in making such allocation among the pools in the state the commission shall take into consideration, among other proper factors, and give due and proper weight to the following:

(d) The prevention of waste in any pool;

(e) the quantity of oil that will be produced from nonprorated pools;

(f) the ratio of the daily productive capacity of each prorated pool to the total daily productive capacity of all prorated pools in the state, after the commission shall have adjusted the said respective daily productive capacities of such pools by such method as the commission may find necessary so that the ratio when so adjusted and applied will result approximately in a fair and equitable allocation of the production among such pools, and as a basis for such adjustment of ratio, the commission shall make a classification of the prorated pools on the basis of the daily average productive capacities of the wells in such pools respectively, giving due consideration to the acreage reasonably attributable to each well, so that the respective pool classifications, in their order from the smallest to the largest, will be allocated a daily rate of production in percentages on a descending scale, but so as to result in a progressively increasing average daily allowed production in barrels per well from the smallest to the largest

pool classification: *Provided, however,* Such reasonable adjustments may be made with respect to any pool or pools as the commission may find to be necessary under the practical circumstances:

(g) the availability of pipelines and other means of transportation;

(h) the reasonable ability of each purchaser to satisfy his or her or its desire for oil produced in this state without concentrating purchases in any selected pool or pools, and the availability of oil to the various purchasers by exchange with or purchase from other purchasers of oil produced in this state;

(i) the quantity of oil which is produced from wells which have been granted temporary bonus or discovery allowables; all to the end that so far as possible no producer or group of producers and no purchaser or group of purchasers shall have or be given any special favor or privilege, that the development and conservation of the oil resources of this state may be encouraged, and that the general welfare and prosperity of oil producers, royalty owners and the general public in this state may be promoted. Such determination and allocation shall be made from time to time as circumstances may require.

(C) In prorating the production allowed to each pool among the wells therein, the commission shall take into consideration, among such other factors as it may find proper, and give due and proper weight to:

(a) The productivity of each such well as determined by such reasonable method as the commission shall adopt for the pool;

(b) the acreage of each well owner which is reasonably attributable to each of the owner's wells; and

(c) the efficient utilization of the reservoir energy in the pool: *Provided*, That the allowable production of any well in any prorated pool shall not be reduced below twenty-five (25) barrels per day: *Provided further*, That the twenty-five (25) barrels per day minimum per well allowable may be reduced proportionately when the acreage attributable to any well is less than the number of acres in a spacing unit established by the corporation commission for wells in a spaced pool. In the absence of such a spacing unit, when the acreage attributable to any well is less than ten (10) acres, the twenty-five (25) barrels per day minimum per well allowable may be reduced in the proportion that the acreage attributable to the well bears to ten (10) acres: *Provided further*, That the reduction in the twenty-five (25) barrels per day minimum per well allowable by virtue of acreage adjustment shall not apply to oil and gas wells drilled or commenced prior to the effective date of this act.

(D) When it shall appear to the commission that those having a right to drill into and produce oil from any pool, part of any pool, or prospective pool, in this state, have unanimously agreed upon a plan for the development of said pool, part of any pool or prospective pool or for the distribution of allowed production therein, then the commission, after notice and hearing, may approve such plan and/or distribution.

K.S.A. 55-701. *Waste of natural gas prohibited.* The production of natural gas in the state of Kansas in such manner and under such conditions and for such purposes as to constitute waste is hereby prohibited.

K.S.A. 55-702. *Definitions.* The term "waste", in addition to its ordinary meaning, shall include economic waste, underground waste and surface waste. Economic waste shall mean the use of natural gas in any manner or process except for efficient light, fuel, carbon black manufacturing and repressuring, or for chemical or other processes by which such gas is efficiently converted into a solid or a liquid substance. The term waste shall not include the use or flaring of natural gas if permitted pursuant to an order issued or rule and regulation adopted under the provisions of subsection (b) of K.S.A. 55-102, and amendments thereto. The term "common source of supply" shall include that portion lying within this state of any gas reservoir lying partly within and partly without this state. The term "commission" shall mean the state corporation commission of the state of Kansas, its successors, or such other commission or board as may hereafter be vested with jurisdiction over the subject matter of this act.

K.S.A. 55-703. *Regulation of production of natural gas by commission; considerations in determination of production from common sources of supply.* Whenever the available production of natural gas from any common source of supply is in excess of the market demands for natural gas from the common source of supply, or whenever the market demands for natural gas from any common source of supply can be fulfilled only by the production of natural gas from the common source of supply under conditions constituting waste, or whenever

the commission finds and determines that the orderly development of and production of natural gas from any common source of supply requires the exercise of its jurisdiction, then any person, firm or corporation having the right to produce natural gas from the common source of supply may produce only that portion of all the natural gas that may be currently produced without waste and to satisfy the market demands, as will permit each developed lease to ultimately produce approximately the amount of gas underlying the developed lease and currently produce proportionately with other developed leases in the common source of supply without uncompensated cognizable drainage between separately-owned, developed leases or parts thereof.

The commission shall regulate the taking of natural gas from any and all common sources of supply within this state in order to prevent the inequitable or unfair taking of natural gas from a common source of supply by any person, firm or corporation and to prevent unreasonable discrimination in favor of any one common source of supply as against another and in favor of or against any producer in any common source of supply. In promulgating rules, regulations and formulas, to attain such results the commission shall give equitable consideration to acreage, pressure, open flow, porosity, permeability and thickness of pay, and such other factors, conditions and circumstances as may exist in the common source of supply under consideration at the time, as may be pertinent.

The commission in determining the market demand for gas from a common source of supply shall consider the reasonable current requirements for

current consumption and use within and without the state, and such other factors, conditions, or circumstances that would aid in establishing the market demand.

K.S.A. 55-703a. *Well spacing and orderly development.* The drilling and completion of a gas well shall not of itself entitle said well to an allowable for production; and the commission may, in its discretion, provide for well spacing in any such common source of supply and provide for the orderly development thereof.

K.S.A. 55-704. *Rules and regulations authorized; notice and hearings.* The commission shall promulgate such rules and regulations as may be necessary for the prevention of waste as defined by this act, the protection of all water, oil or gas-bearing strata encountered in any well drilled in such common source of supply, ascertaining the several factors entering into the determination of the productive capacity of each well, the total productive capacity of all wells in the common source of supply, the establishment of such other standard or standards as the commission may find proper to determine the productive capacity of each well and of all wells in such common source of supply, and as the commission may find necessary and proper to carry out the spirit and purpose of this act: *Provided, however,* That notice, as provided in K.S.A. 55-706, shall be served upon or given to the producers and purchasers of natural gas and all other persons, firms or corporations interested, of any hearing or hearings which may be called for the purpose of establishing any facts upon which any proposed rule or regulation may be based.

K.S.A. 55-705a. *Certificate required; notice and*

hearing. Before any gas shall be produced from a well producing gas only, or from a well which is primarily a gas well, for any of the purposes specified in K.S.A. 55-702, a certificate shall be obtained from the commission for the construction of the facilities necessary or required and/or the utilization of the gas in the manner and for the purposes intended; and the commission shall issue such certificate unless it finds, upon application and after hearing, that the contemplated production or use of such gas is in violation of this act: *Provided, however,* That no such certificate shall be required on account of such facilities as were in existence or under construction, or such uses as were being made of such gas, on February 1, 1945.

Kansas Administrative Regulations

K.A.R. 82-3-101. *Definitions.* (a) As used in these regulations: (1) "Acreage factor" means the quotient obtained by dividing the acreage attributable to a well by the basic acreage unit. The basic acreage unit shall be defined by the commission and promulgated in the basic proration order for the common source of supply in which the well is located.

(2) "Allowable" means the amount of oil or gas authorized to be produced by order of the commission.

(3) "Allowable period" means the time in which the allowable may be produced.

(4) "Assessment" means any charge against the parties involved in any hearing, application, investigation, or the enforcement of an order, and the assessment on natural gas and oil produced to pay the costs associated with the administration of the oil or gas conservation act.

(5) "Attributable acreage" means the acreage

assigned to a well in accordance with the well spacing program adopted for each of the prorated fields.

(6) "Casing" means tubular goods used to line a well bore.

(7) "Casing-head gas" means gas produced that was in solution with oil in its original state in the reservoir.

(8) "Cement" means Portland cement or a blend of Portland cement used in the oil and gas industry to support and protect casing and to prevent the migration of subsurface fluids by the formation of an impermeable barrier.

(9) "Combination well" means a well productive of both oil and gas, excluding casing-head gas, from the same common source of supply.

(10) "Commingling" means the mixing of production from more than one common source of supply.

(11) "Commission" means the state corporation commission.

(12) "Common source of supply" means each geographic area or horizon definitely separated from any other area or horizon which contains, or appears to contain, a common accumulation of oil or gas or both.

(13) "Conservation division" means the division of the commission in charge of the administration of the oil and gas conservation acts, well plugging, salt water disposal, and enhanced recovery.

(14) "Correlative rights" means that each owner or producer in a common source of supply is privileged to produce from that supply only in a manner or amount that will not injure the reservoir to the detriment of others, take an undue proportion of the obtainable oil or gas, or cause undue drainage between developed leases.

(15) "Day" means a period of 24 consecutive hours.

(16) "Deliverability" means the amount of natural gas, expressed in m.c.f. per day, which a well is capable of producing into a pipeline, while maintaining a back-pressure against the well head. The amount of back-pressure to be maintained and the test procedure shall be specified by the commission in the basic proration order for the common source of supply in which the well is located.

(17) "Discovery well" means the first well completed in a common source of supply which is not in communication with any other common source of supply.

(18) "Disposal well" means a well which injects, for purposes other than enhanced recovery, those fluids brought to the surface in connection with oil and natural gas production.

(19) "Division order" means a dated written statement, duly signed by the owners and delivered to the purchasers, certifying and guaranteeing the interests of ownership of production, and directing payment according to those interests.

(20) "Enhanced recovery" means any process involving the injection of fluids into a pool to increase the recovery of oil or gas.

(21) "Enhanced recovery injection well" means a well which injects fluids to increase the recovery of hydrocarbons.

(22) "Field" means a geographic area containing one or more pools.

(23) "First purchaser" means the person holding the division order and issuing checks to pay any working or royalty interest.

(24) "Fluid" means a material or substance which flows or moves in a semi-solid, liquid, sludge, or gas state.

(25) "Gas" means the gas obtained from gas or

combination wells regardless of its chemical analysis.

(26) "Gas" (cubic foot) means the volume of gas contained in one cubic foot of space at a standard pressure base and at a standard temperature base. The standard pressure base shall be 14.65 pounds per square inch absolute, and the standard temperature base shall be 60 degrees Fahrenheit. Whenever the conditions of pressure and temperature differ from the above standard, conversion of the volume from these conditions to the standard conditions shall be made in accordance with the ideal gas laws as corrected for deviation.

(27) "Gas-oil ratio" means the ratio of gas produced in cubic feet to one barrel of oil produced during the concurrent period.

(28) "Gas" (sour) means any natural gas containing more than 1 grains of hydrogen sulphide per 100 cubic feet or more than 30 grains of total sulphur per 100 cubic feet, or gas which in its natural state is found by the commission to be unfit for use in generating electricity or fuel for domestic purposes.

(29) "Illegal production" means any production in violation of the statutes, rules, regulations or orders of the commission.

(30) "Minimum well" means any oil well which has a productivity of 25 barrels or less per day.

(31) "Mousehole" means a service hole drilled at a slight angle and normally about 30 feet deep on those wells drilled by rotary tools.

(32) "Mud-laden fluid" means any commission approved mixture of water and clay or other material, as the term is commonly used in the industry, which will effectively seal a formation to which it is applied.

(33) "Oil" means crude oil or petroleum and shall

include all waste oil which is removed from the lease.

(34) "Oil, (pipeline)" means oil free from water and basic sediment to the degree that it is acceptable for pipeline transportation and refinery use.

(35) "Oil well" means any well producing oil.

(36) "Open flow" means the volume of gas which a gas well is capable of producing at the wellhead during a period of 24 hours against atmospheric pressure, computed according to the standard procedure approved by the commission.

(37) "Operator" means any person who is in charge of the development of a lease, or the operation of a producing well.

(38) "Overage" or "overproduction" means the oil or gas produced in excess of the allowable.

(39) "Person" means any natural person, corporation, association, partnership, governmental or political subdivision, receiver, trustee, guardian, executor, administrator, fiduciary, or any other legal entity.

(40) "Pipeline" means any pipes above or below the ground used or to be used for the transportation of oil, gas liquids, or gases.

(41) "Pool" means a common source of supply as officially named.

(42) "Producer" means any person who owns, in whole or in part, a well capable of producing oil or gas or both.

(43) "Production" means produced oil, gas, condensate, or casing-head gas.

(44) "Productivity of a well" means the daily capacity of a well to produce oil or gas.

(45) "Productivity of a pool" means the sum of the productivities of the wells completed in the pool.

(46) "Proration" means the regulation of the amount of allowed production to prevent waste, un-

due drainage between developed leases, unratable taking, or unreasonable discrimination between operators, producers and royalty owners who are within a common source of supply, that would favor any one pool as compared to any other pool in this state.

(47) "Purchaser" means any person who purchases production from a well, lease or common source of supply.

(48) "Rathole" means the service hole drilled at a slight angle and normally about 40 feet deep on those wells drilled by rotary tools.

(49) "Reasonable market demand" means the amount of crude petroleum or natural gas which must be produced to satisfy current rates of consumption.

(50) "Service well" means a well drilled for:

(A) The injection of fluids in enhanced recovery projects; or

(B) The supply of fluids for enhanced recovery projects; or

(C) The disposal of salt water.

(51) "Shortage" means the amount by which the oil or gas legally produced and sold or removed from the premises is less than the allowable.

(52) "Storage oil" means produced oil confined in tanks, reservoirs, or containers.

(53) "Storage oil-lease" means produced oil in tanks, reservoirs, or containers on the lease where it was produced.

(54) "Storage well" means a well used to inject or extract hydrocarbons for storage purposes.

(55) "Stratigraphic hole" means a hole normally of small diameter, drilled through subsurface strata for exploratory purposes, with no intent to produce hydrocarbons through the hole being drilled.

(56) "Undue drainage" means the uncompensated migration of either oil or gas between developed leases within the same common source of supply caused by the unratable production of some well or wells located there.

(57) "Waste oil" means any tank bottom, basic sediment, cut oil, reclaimed oil from pits, ponds or streams, dead oil, emulsions, or other types of oil not defined as pipeline oil.

(58) "Well completion, (oil)" occurs when the first new oil is produced through permanent wellhead equipment into lease tanks from the producing interval after the production casing has been run.

(59) "Well completion, (gas)" occurs when the well is capable of producing gas through permanent wellhead equipment from the producing zone after the production casing has been run.

(60) "Well completion, (dry hole)" occurs when all provisions of plugging are complied with as set out in these regulations.

(61) "Wellhead working pressure" means the static pressure in the annulus while flowing through the tubing or static pressure in the tubing while flowing through the annulus, except in cases where the casing-head is not in open communication with the producing formation because of the presence of a packer or other obstruction in the annular space between casing and tubing. In these cases, the wellhead working pressure shall be determined by adjusting the observed tubing pressure for the effect of friction caused by flow through the tubing, or by using a bottom-hole pressure bomb and correcting back to wellhead conditions.

(62) "Well log" means the written record progressively describing the well's down-hole development.

(63) "Well history" means the chronological record of the development and completion of a well.

(b) All terms not defined in this definitional section shall be interpreted to be consistent with their common use in the industry. (Authorized by and implementing K.S.A. 55-602, 55-604, 55-704, K.S.A. 1982 Supp. 55-152, 55-901; effective, T-83-44, Dec. 8, 1982; effective May 1, 1983).

Paragraphs (1)-(p) of the Basic Proration Order for the Hugoton Gas Field (prior to the 1983 Amendment of paragraph (p)

(1) The determine a well's quota for a given proration period, determine first the proration factor for the field by dividing the total field market demand for such period by the sum of the products of deliverability times the acreage factors of all wells in the pool, then multiply the field proration factor by the product of the deliverability times acreage factor for the well. The result reached by this calculation, as hereinafter adjusted, shall constitute the well's current allowable, in cubic feet, which it may produce for such proration period, provided, that if the current allowable so determined for any well is less than 50 MCF per day, the well shall be assigned a minimum current allowable of 50 MCF times the number of days in the proration period, unless the acreage factor for such well is either more or less than one (1). In that event, the minimum allowable so assigned shall be adjusted by multiplying said minimum allowable times the acreage factor. In order that the allocation to wells within the field may be restricted to the market demand figure determined for the proration period, the proration factor as first determined, shall then be adjusted by computer computation, allowing for

the additional gas necessary for allocation to minimum allowable wells.

Each operator of a well authorized a minimum allowable shall, within 90 days after this order becomes effective, file with the Conservation Division, an affidavit (on a form to be furnished by the Conservation Division upon request) stating that, in the operator's opinion, the well is capable of producing the minimum allowable; the production of the minimum allowable will not be detrimental to the well thereby causing premature abandonment; and the productive capacity of the well cannot be improved by artificial means. Unless such affidavit is filed, the well shall be granted only such allowable as will be assigned by virtue of its adjusted deliverability. Wells which qualify for minimum allowables in the future shall be granted only such allowables as would be assigned by virtue of their adjusted deliverabilities until such time as the affidavits referred to above are filed with the Conservation Division.

(m) That the production of gas in accordance with the above formula has a reasonable relation to prevention of waste, to the prevention of inequitable and unfair production of gas from the common source of supply, and to the prevention of unreasonable discrimination in favor of one producer in said field and against another producer therein and that production of gas in such manner will in fact accomplish the purposes for which article 7, Chapter 55, General Statutes of Kansas for 1935, was enacted. (Kansas Statutes Annotated).

(n) That there shall be held two market demand hearings for each year. The first hearing shall cover the period from October 1st to March 31st, both inclusive, and the second shall cover the period from

April 1st to September 30th, both inclusive. The allowable period established shall be a calendar month. The Commission shall issue its orders covering each allowable period, and such orders shall be issued on, or near, the first day of the month for which such order is issued.

(o) At such time and place as the Commission shall fix, the Commission will, after notice, conduct a hearing to determine the market demand for natural gas from said field for the next six succeeding proration periods, or for such other period of time as the Commission shall prescribe, and at said hearing may determine any other questions which may properly and legally come before the Commission for consideration thereat, and a new schedule of production allowable for the wells in said field, based upon the determination made as a result of such hearing, shall be prepared and promulgated for the ensuing proration periods.

(p) Operators of wells and purchasers or others taking gas from any well, shall endeavor to limit their takes of gas to the quantities fixed in the schedule as the allowable production for such well, provided that if, during the period covered by any schedule, there should develop a substantial increase in the amount of the market demand for gas from said field, the Conservation Division may permit production to be increased ratably from all the wells in the field to meet such emergency increased demand and the facts respecting same shall be reported to the Commission at or before the next periodic market demand hearing for such action thereon as may be proper. If, at the end of any proration period, there is an overage or underage in production for any well during such period, the same shall be carried forward as a charge against or credit

in favor of such well and subtracted from or added to, as the case may be, the allowable for such well for the next proration period. Any well with an adjusted deliverability in excess of 300 MCF may accumulate overproduction equivalent to six times the amount of the current allowable assigned to it for the preceding January before being shut in by the operator or producer and shall not be permitted to produce any gas until such overproduction has been reduced by deductions from such overproduction made by current allowables to the extent that the well shall not be overproduced more than five times the current allowable assigned to it for the preceding January. When any well with an adjusted deliverability in excess of 300 MCF has accumulated underproduction in excess of six times the current allowable assigned to it for the preceding January, such excess shall thereupon be cancelled. Any well with an adjusted deliverability of less than 300 MCF may accumulate overproduction equivalent to nine times the amount of the current allowable assigned to it for the preceding January before being shut in by the operator or producer and shall not be permitted to produce any gas until such overproduction has been reduced by deductions from such overproduction made by current allowables to the extent that the well shall not be overproduced more than eight times the current allowable assigned to it for the preceding January. When any well with an adjusted deliverability of less than 300 MCF has accumulated underproduction in excess of nine times the current allowable assigned to it for the preceding January, such excess shall thereupon be cancelled. Any underage cancelled by the terms of this paragraph shall not be considered in determining the future production

of any such well, unless, upon notice and hearing, the Commission shall otherwise determine. *Provided, however,* that in no event shall any underproduction of an unconnected well be cancelled.

Provided also that underages cancelled under the provisions of this paragraph will be reinstated upon verified application therefore, showing that the wells are in an overproduced status; that the purchaser is willing and able to take the amounts of gas; and that the length of time proposed by applicant for the production of the amounts of gas to be reinstated is reasonable under the circumstances.

Order Dated 11-25-75

The basic allowable (preceding January current allowable) for new wells or wells retested with the approval of the Conservation Division shall be computed by using the same field allowable factor as was used for other wells in the preceding January.

APPENDIX J

The Williams Companies
- Agrico Chemical Company
  - Agrico Canada Limited/Limitee
  - Agrico Chemical of Oklahoma, Inc.
  - Agrico Disc, Inc.
  - Agrico Egypt Limited
  - Agrico Foreign Sales Corporation
  - Agrico North Carolina Properties, Inc.
  - Agrico Thailand, Inc.
  - *Crop Production Services, Inc.
  - Fishhawk Ranch, Inc.
  - The American Agricultural Chemical Company
- *BancOklahoma Corp.
- F T & T, Inc.
- Kern River Gas Supply Corporation
- Kern River Service Corporation
- Langside Limited
- Louisiana Gas Marketing Company
- Louisiana Resources Company
- NGL Production Company
- Northwest Alaska Company
- Northwest Energy Company
  - Ap Sci, Inc.
  - Apco Argentina Inc.
    - Apco Properties Ltd.
  - Inner Ocean Services Company
  - Inner Ocean Services, Inc.
  - Northwest Alaskan Pipeline Company
  - Northwest Border Pipeline Company
  - Northwest Canadian Gas Sales Company
  - Northwest Coal Corporation
    - Western Slope Carbon, Inc.
  - Northwest Field Services Company

- Northwest International Company
  - Northwest Argentina Corporation
- Northwest Investments, Incorporated
- Northwest Land Company
- Northwest Marketing Company
- Northwest Overseas Capital Corporation N.V.
  - Northwest International Finance B.V.
    - Northwest International Finance N.V.
- Northwest Pipeline Corporation
- Pacific Northwest Realty Corporation
- Williams Natural Gas Company**
- Northwest Exploration Company
  - Northwest Canada Exploration Company
- Tulsa Williams Company
- Willco, Inc.
- Williams Brothers International Corp.
- Williams Exploration Company
  - Paraffine-Williams Company
  - Rainbow Resources, Inc.
  - Williams Drilling Company of Tulsa
- Williams Gas Company
- Williams Gas Marketing Company
- Williams Gas Supply Company
- Williams Natural Gas Liquids Company
- Williams Pipe Line Company
  - WillBros Terminal Company
  - Williams Terminals Company
- *Williams Realty Corp.
  - Atria Hotel, Inc.
  - Cafes On The Ice, Inc.
  - 1400 Market Street, Inc.
  - Kennedy Tower, Inc.
  - Metro Center, Inc.
  - 320 South Boston, Inc.
  - Tulsa Union Depot, Inc.
  - Willcentro, Inc.

Williams Center Forum, Inc.
Williams Center, Inc.
Williams Center Plant, Inc.
Williams Center Tower I, Inc.
Williams Center Tower II, Inc.
Williams Plaza Hotel, Inc.
The Barristers Club, Inc.
Williams Real Estate Services, Inc.
Williams Realty Developments, Inc.
Williams Realty Interest, Inc.
Williams Realty of Charlotte, Inc.
Writers Square Condominium, Inc.
WRC of Colorado, Inc.
WRC of Crown Center, Inc.
WRC of Kansas, Inc.
WRC of San Antonio, Inc.
WRC of Texas, Inc.
WRC of Utah, Inc.
Williams Telecommunications Company
WilTel of California, Inc.
WilTel of Illinois, Inc.
WilTel of Kansas, Inc.
Williams Western Pipeline Company

*Companies not consolidated.
**Formerly Northwest Central Pipeline Corporation

MOTION

FILED
JUN 22 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1856

In the Supreme Court of the United States

OCTOBER TERM, 1986

NORTHWEST CENTRAL PIPELINE CORPORATION,
Appellant,

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, et al.,
Appellees.

ON APPEAL AFTER REMAND TO THE SUPREME COURT OF KANSAS

MOTION TO AFFIRM OR DISMISS

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QUESTIONS PRESENTED

1. Whether orders issued by the Kansas Corporation Commission amending the Basic Proration Order for the Hugoton Gas Field invade the exclusive jurisdiction of the Federal Energy Regulatory Commission?

2. Whether the orders amending the Basic Proration Order for the Hugoton Gas Field unconstitutionally burden interstate commerce?

3. Whether this Court intends *Transcontinental Gas Pipeline v. State Oil and Gas Board of Mississippi*, 474 U.S. 409 (1986) to extend the doctrine enunciated in *Northern* to pre-empt state regulatory activity that might indirectly impact the purchasing and contracting practices of an interstate pipeline?

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No. 86-1856

In the Supreme Court of the United States

OCTOBER TERM, 1986

NORTHWEST CENTRAL PIPELINE CORPORATION
Appellant,

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, et al.,
Appellees.

ON APPEAL AFTER REMAND TO THE SUPREME COURT OF KANSAS

MOTION TO AFFIRM OR DISMISS

The Appellees move this Court to affirm the decision of the Kansas Supreme Court, or in the alternative dismiss the appeal of Appellant on the grounds that this case does not present this Court with a substantial federal question.

STATEMENT OF THE CASE

A. Introduction

This appeal questions the authority of the Kansas Corporation Commission (Commission) to enter orders amending the Basic Proration Order for the Hugoton Gas Field. These orders, directed to producers of gas, set forth how an unproduced allowable (underage), which has been cancelled pursuant to the terms of the proration order, may be reinstated and produced.

B. Facts

The Commission accepts the recitation of the facts set forth in the Appellant's Jurisdictional Statement, with the following clarifications.

The Basic Proration Order was issued by the Kansas Commission in 1944 to govern production from the enormous Hugoton reservoir. At various times the provisions of the Basic Order have been amended to reflect the changes in field conditions or market demand. The provision at issue in this appeal, Paragraph (p), has been altered several times to accommodate changes in the field.

Twice each year the Commission considers the projected requirements of the pipelines connected to the field and allocates the demand for gas to the various wells. The objective of the basic order is to give each well the opportunity to produce its underlying reserves through a formula designed to cause a uniform reduction in pressures in the Hugoton Field, consistent with current market demand. Underages attributed to wells in the field accrue when the wells produce less than their current allowable. The fact that any particular well has accumulated significant underage simply indicates that its allowed production is not being purchased by the connected pipeline.

Appellant states that since 1963 "huge" underages have developed as a result of the setting of market demand by the Commission. It must be pointed out that no appeal has been taken in recent years of any market demand order relating to the Hugoton Field. The last reported case concerned with the Commission's market demand determinations for the Hugoton Field was *Colorado Interstate Gas Co. v. State Corporation Commission*, 192 Kan. 1, 386 P.2d 266 (1963), *cert. denied*, 379 U.S. 131 (1964).

In 1982 the Commission began an investigation to determine if changes should be made in the Basic Order because of the amounts of underage which were accumulating to some wells. Paragraph (p) of the Basic Order limits both the amounts of overproduction which may occur before a well is shut-in, or conversely the amount of underproduction which can accumulate before cancellation.

All parties at the hearing were in agreement on two points. First, the deliverability formula in the Basic Order is the best method for regulating production from the Hugoton Field. Second, the only solution to the underage problem would be to increase production from the underproducing wells. It was also clear that correlative rights were being violated due to the gas drainage from underproducing wells towards higher producing wells. The disagreement at the hearing centered on how the Commission could best amend Paragraph (p), if at all, to address the problems created by large accumulations of underage while pursuing its statutory duty under K.S.A. 55-703 to regulate gas production in an equitable, non-wasteful fashion.

The orders amending Paragraph (p) set forth reasonable terms under which cancelled underage must be reinstated and produced. When underages attributed to most of the field's wells exceeds six times the January current allowable (typically the largest monthly allowable), the underage is cancelled. The producer also has three years after the cancellation date to request reinstatement once the well reaches an overproduced status. In addition, the reinstated underage must be produced within five years or be permanently cancelled. The Gray County District Court and the Kansas Supreme Court

reviewed these orders and concluded that they were lawful and reasonable, and affirmed the Commission's actions. Both of these courts noted that the orders were aimed solely at producers and were related to the production and gathering of gas, an area wholly within the province of the state. Although the permanent cancellation of some amount of unproduced allowables may have a minimal, incidental effect upon the purchasing practices of connected interstate pipelines, the Commission submits that this possible indirect effect does not rise to the level of a substantial federal question that will engage the jurisdiction of this Court.

ARGUMENTS IN SUPPORT OF MOTION TO DISMISS OR AFFIRM

1. The Amendment to Paragraph (p) Does Not Invade the Jurisdiction of the Federal Energy Regulatory Commission.

For over fifty years most of the producing states have had in effect integrated programs regulating allowable production levels and purchasing practices. There are at least three clearly recognized goals of state regulation of gas production and gathering; (1) protection from monopsony power, (2) protection of correlative rights, and (3) conservation.

Since the enactment of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*, the environment in which states must attempt to further the multiple goals of regulation of gas production and purchasing has been somewhat murky. However, it is beyond cavil that Congress has specifically created a dual system of natural gas regulation between the federal and state governments.

It is equally well settled that the production and gathering of natural gas is reserved to the jurisdiction of the states. Congress has specifically excluded the area of "production and gathering" from the FERC's jurisdiction in the Natural Gas Act (NGA). 15 U.S.C. 717(b).

On numerous occasions this Court has held that the federal statutes do not apply to the production and gathering of natural gas. "Production" and "gathering" are terms narrowly confined to physical acts of drawing gas from earth and preparing it for the first stages of distribution. *Northern Natural Gas Co. v. State Corporation Commission,* 372 U.S. 84 (1963). In *United Gas Improvement Co. v. Continental Oil Co.,* 381 U.S. 392 (1965), this Court stated that the "exemption of production of gathering relates to physical activities, processes, and facilities of production or gathering, but not to sales of the kind affirmatively subjected to jurisdiction of Federal Power Commission (now FERC)." 381 U.S. at 402.

Recognition of this dual system of regulation is crucial because it is from this perspective that the proper Congressional intent is derived. The critical question in any pre-emption analysis is always whether Congress intended that the federal statute or regulation supercede state law. *Rice v. Santa Fe Elevator Corp.,* 331 U.S. 218 (1946). There is no doubt that Congress did not intend that these federal regulations supercede state law, rather, it was Congress' specific intent that regulation of natural gas be conducted under a dual scheme of jurisdiction between the Federal and State Governments. *FPC v. Louisiana Power and Light Co.,* 406 U.S. 621 (1972). Nothing in the NGPA alters this clear expression of Congressional intent.

The only arguable point raised by Appellant is whether or not the state law stands as an obstacle to the accomplish-

ment and execution of the full objectives of Congress. Appellant argues that the orders amending Paragraph (p) do indeed stand in the way of fulfillment of Congressional objectives, albeit indirectly. However, such assertion must be viewed in light of a more recently decided case, *Louisiana Public Service Comm. v. F.C.C.*, 476 U.S. ....., 90 L.Ed.2d 369, 106 S.Ct. 1890 (1986). In *Louisiana PSC*, this Court reversed an order of the Federal Communications Commission (FCC) which attempted to pre-empt inconsistent state depreciation regulations. In similar fashion to Appellant, the FCC argued that federal dis-displacement of state regulation was justified in order to avoid frustration of validly adopted federal policies. Although urged to give a broad reading to Section 151 of the Communications Act of 1934, this Court noted that "we might be inclined to accept this broad reading . . . were it not for the express jurisdictional limits on FCC power . . ." 106 S.Ct. at 1899. The Court then stated:

> "In deciding these cases, it goes without saying that we do not assess the wisdom of the asserted federal policy of encouraging competition within the telecommunications industry. Nor do we consider whether the FCC should have the authority to enforce, as it sees fit, practices which it believes would best effectuate this purpose. Important as these issues may be, our task is simply to determine where Congress *has* placed the responsibility for prescribing depreciation methods to be used by state commission in setting rates for intrastate telephone service." 106 S.Ct. at 1893. (Emphasis in original).

The rationale found in *Louisiana PSC* is equally applicable to this case. There can be no question that regulation of the natural gas industry is divided between state and federal regulatory agencies. The Natural Gas Act, 15

U.S.C. § 717 *et seq.*, the Department of Energy Organization Act, 42 U.S.C. § 7172(a) and the Natural Gas Policy Act, 15 U.S.C. 3301 *et seq.*, grant FERC the authority to regulate the rates and charges made by companies engaged in the interstate transportation or sale of natural gas. However, it is equally clear that Federal law explicitly grants to the states the authority to regulate the production and gathering of natural gas. Kansas, and a host of other states, traditionally exercise this Congressionally granted authority by establishing regulations governing the production of natural gas, usually through production units, production pools, or proration goals. Indeed, other than setting allowables and proration policies, there is no other mechanism to regulate production and gathering of natural gas. Appellant claims that the permanent cancellation of some unproduced allowable *may* have an effect upon the purchasing practices of connected interstate pipelines, and therefore frustrate federal policy. As in *Louisiana PSC*, the NGPA and NGA do not support the erroneous conclusion that Congress intended to pre-empt traditional state authority. Indeed, the opposite is true. Congress fully intended and explicitly mandated dual regulatory authority.

2. Under the Clearly Enunciated Principles Decided by This Court, Paragraph (p) Does Not Constitute an Impermissible Burden Upon Interstate Commerce.

For nearly fifty years this Court has realized the inevitability of some impact on the interstate market by state regulatory efforts, and has accorded due weight to the importance of the states' legitimate concerns. This Court has stated that "The states may constitutionally prorate production in order to prevent undue drainage of gas

from the reserve of well owners lacking pipeline connections . . . The fact that plaintiff's gas is in interstate commerce would not preclude such exercise of state power." *Thompson v. Consolidated Gas Utilities*, 300 U.S. 55, 76-77 (1937).

Appellant argues that by pursuing this legitimate state concern the Commission has engaged in economic protectionism. This argument is false. The orders at issue were designed to prevent undue drainage through the production of allowables in a more timely fashion. Moreover, the orders were directed to *all* producers in the Hugoton Field and were not intended nor do they have the effect of favoring any particular group of wells in the field. Clearly, uniform state regulation which furthers a legitimate state interest with possible, incidental effects on interstate commerce will be upheld unless the burden imposed is excessive in relation to the putative local benefits. *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375 (1983).

Each producer has been assigned allowables in a uniform manner, and the failure to produce by any or all results in allowable cancellations in a known and equal manner. The alleged burden upon interstate commerce, if such an impediment ever comes to pass, will be that the pipeline will not be able to purchase underage that has been permanently cancelled. There will be a current allowable and presumably, in many cases, accumulated underage that can be purchased from each well to permit the pipeline to meet its obligations. The orders at issue are not violative of the Commerce Clause and do not warrant review by this Court.

3. This Court's Holding in Transcontinental Gas Pipeline v. State Oil and Gas Commission Does Not Extend the Doctrine Enunciated in Northern to Pre-empt Any State Regulatory Authority That Might Indirectly Impact the Purchasing and Contracting Practices of the Interstate Pipeline.

The ultimate question posited by Appellant is clear: Does this Court intend in *Transcontinental Gas Pipeline v. State Oil and Gas Board of Miss.*, 474 U.S. 409 (1986) to extend the *Northern* doctrine to pre-empt any state regulatory authority that might indirectly affect the purchasing and contracting practices of an interstate pipeline. While it is true that *Transcontinental* reaffirms the continuing validity of the doctrine espoused in *Northern*, nothing in the *Transcontinental* decision can be stretched to the limits urged by Appellant. Indeed, where preemption is concerned, Appellees interpret *Transcontinental* in light of the more recent case, *Louisiana PSC*. *Louisiana PSC* firmly rejected the proposition that the FCC had implicit authority to pre-empt inconsistent state regulation which frustrates federal authority. Rather, this Court held that express jurisdictional limitations set out by Congress in federal-state regulatory schemes control. Likewise, the NGPA specifically preserves traditional state regulatory authority and exempts from federal jurisdiction "gas production and gathering." 15 U.S.C. § 717 (b). Kansas has merely exercised traditional state authority over intrastate producers to protect correlative rights. Indeed, there is no mechanism the state can use to exercise its regulatory authority over gas production and gathering other than the setting of allowables, and proration policies.

While Appellant urges that the *Transcontinental* and *Northern* rationales control in this case, it is important to note the numerous legal and factual distinctions which show Appellant's argument to be false. At the outset it is important to note that Appellees have never contended that *Northern* has been overruled. Simply stated, *Northern* does not apply to the issues in this case. In addition, both *Transcontinental* and *Northern* involved state action directed at interstate pipelines, while the Kansas orders were solely directed at producers. Further, *Transcontinental* and *Northern* concerned virtually identical regulations, "ratable take" orders requiring interstate pipelines to purchase gas ratably, *regardless of price*, from parties owning interests in a common gas pool. This case only indirectly, if at all, affects interstate purchasers and merely exercises traditional and well-established police power over gas production, furthering a legitimate state conservation concern.

Finally, the orders in *Transcontinental* required the pipelines to take ratably from a field and thus actively and directly interferred with its business practices. The orders in Paragraph (p) are not directives by any stretch of the imagination. The orders merely set out a schedule within which underage may be reinstated and produced before they are cancelled. The business decision is left to those involved in the production and gathering of natural gas. Moreover, the time schedule was originally phased-in and has since been amended to provide even greater latitude to the parties. This was not the case with *Transcontinental* which orders were effective immediately.

By restraining the business decisions of interstate pipelines, the orders at issue in *Transcontinental* placed

a direct, impermissible burden on interstate commerce. However, the impact of the producer directed orders of the Kansas Commission will be indirect, inconclusive, and will vary with each pipeline.

On February 24, 1986, the Court remanded this case back to the Kansas Supreme Court for further consideration in light of *Transcontinental*. On remand the Kansas Court correctly concluded that the Kansas orders do not create an impermissible burden on interstate commerce. Appellant's arguments to the contrary are without merit.

CONCLUSION

Appellant's Jurisdictional Statement does not raise a substantial federal question. At issue in this appeal are administrative orders pertaining to the production of natural gas, a traditional state function. These orders do not impinge upon federal authority nor do they create an impermissible burden on interstate commerce. The opinion of the Kansas Supreme Court affirming the Commission's decision is in no way inconsistent with the decision of this Court in *Transcontinental*. This appeal should be dismissed and the state court decision affirmed in all respects.

Respectfully submitted,

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BRIEF

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ON APPEAL AFTER REMAND TO THE SUPREME COURT OF KANSAS

BRIEF OPPOSING MOTION TO AFFIRM OR DISMISS

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BRIEF OPPOSING MOTION TO AFFIRM OR DISMISS

Appellant, Northwest Central Pipeline Corporation (Northwest Central), submits the following brief in opposition to the Motion to Affirm or Dismiss (Motion) filed by appellee State Corporation Commission of the State of Kansas (Commission).

STATEMENT OF FACTS

The Commission has accepted the statement of the facts as set forth in Northwest Central's Jurisdictional Statement

(J.S.) at 3-11, subject to certain "clarifications." Motion at 2-4. These clarifications are not entirely accurate.

The record reveals that the parties appearing before the Commission did not agree that "the only solution to the underage problem would be to increase production from the underproducing wells." Motion at 3. The witness sponsored by Northern Natural Gas Company suggested that the Commission should reduce the inflated allowables to the level of the current market demand, instead of cancelling the right of underproduced operators to take back the gas lost through drainage to overproduced wells. J.S. at 71a. The Commission chose to disregard the suggestion of Northern Natural's witness that allowable production limits should be related to existing market demand. The Commission found that reducing the allowables to the existing market demand would frustrate the on-going effort of the overproduced operators to take more gas than exists within that portion of the reservoir underlying their lands. J.S. at 73a. According to the Kansas Supreme Court, the basis for this finding is found in the testimony of the witness sponsored by Mesa Petroleum Company, whose gas is purchased by Kansas Power and Light Company, an intrastate utility. J.S. at 34a-36a. Mesa's witness testified that low market demand had decreased the allowables for Hugoton Field wells to such an extent that Kansas Power and Light Company had been forced to purchase gas on the open market, at a price higher than the price at which Hugoton Gas could be purchased. J.S. at 35a. This testimony is the sole factual predicate for the Commis-

sion's determination that an "incentive" to compel increased production was needed. This determination was completely unrelated to an issue of correlative rights, but instead was founded upon a desire to increase, by state regulation, the "market" demand to a point where the Kansas gas utility company could purchase all the Kansas gas it needed from Mesa Petroleum Company at the lowest possible price rather than purchase other gas on the open market. The determination demonstrably was not founded upon an agreement by the parties that increased production was the only remedy available to correct the production imbalance in the Hugoton Field.

The Commission admits that the permanent cancellation of unproduced allowables may have an effect upon the purchasing practices of interstate pipelines, but suggests that the effect could be "minimal, incidental" and "indirect." Motion at 4. The Commission's statement of the factual issue misses the point. The effect of the order at issue can never be accurately measured in mathematical terms, because the order is designed alternatively to compel increased purchases by interstate pipelines or to take away dedicated reserves if purchases are not promptly increased. Quite simply, if the pipelines refuse to increase their purchases in response to the threat of losing their dedicated reserves, they will in fact lose some reserves. *See* J.S. at 58a (Finding of Fact No. 12). This result is not "incidental," it is the precise and intended result of the Commission's order.

ARGUMENT

THE PURPOSE OF THE CHALLENGED ORDER WAS TO MODIFY THE PURCHASING PRACTICES OF INTERSTATE PIPELINES IN AN IMPERMISSIBLE MANNER

In its second opinion, the Kansas Supreme Court laid bare the fundamental purpose underlying the order of the Commission.

> The Commission has exercised its authority in this case by limiting the time in which producers may reinstate underages. Placing such a limitation on recovery of underages is a part of the Commission's authority to prorate and control production to prevent economic and physical waste and *to protect correlative rights between producers in the Kansas Hugoton Gas Field and those in the Oklahoma and Texas Hugoton Field.*

J.S. at 11a (emphasis added).

Beginning in 1956, the Kansas Corporation Commission has been setting its allowables for Kansas production at a level in excess of market demand, hoping to thereby induce pipeline companies to take a larger proportion of the gas from the Kansas portion of the Hugoton Field, which extends into Oklahoma and Texas. *See* Memorandum for the Federal Power Commission as Amicus Curiae, *Northern Natural Gas Company vs. State Corporation Commission of the State of Kansas,* October Term 1962 (FPC Memorandum), at 6-12. For example, Corporation Commission Chairman Beatty noted in 1958:

> If allowables are set high enough, or if high allowables continue long enough, admittedly the result will be to force underproduced pipe line companies to take and dispose of more Kansas gas or suffer cancellation of their underproduced allowables. The higher the allowables, the greater the coercion, the greater the cancellations and the more severe the penalties.

Kansas Corporation Commission Order dated January 22, 1958, found in the FPC Memorandum as Appendix C, at 51. The Commission sought to increase the coercion by promulgating an order requiring pipeline companies to take gas "ratably" from all wells to which they were connected. This order was struck down by the Court in *Northern Natural Gas Co. v. State Corporation Commission,* 372 U.S. 84 (1963).

From 1972 through 1981 the national shortage of natural gas permitted the huge quantity of cancelled underage to be reinstated and produced. After 1981, however, the weak interstate gas market resulted in a recurrence in the accumulation of underages. The Commission's response was to enter the order challenged herein.

The challenged order can only have one of two effects. Interstate pipelines will either change their "mix" of gas so as to take all gas available from the Kansas Hugoton Field, or some of the dedicated gas made available but not taken within the prescribed time period will be lost permanently to wells that have taken the gas. J.S. at 58a (Finding of Fact No. 12).

To the extent the order seeks to compel a readjustment

of purchasing patterns of interstate pipelines, the order is plainly unlawful under this Court's prior decisions. *See Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board,* 474 U.S. 409 (1986); *Northern Natural Gas Co. v. State Corporation Commission, supra,* 372 U.S. at 92 (compelled readjustment of purchasing patterns of interstate pipelines impairs the federal regulatory scheme). If, on the other hand, interstate pipelines do not increase their purchases from the Kansas Hugoton Gas Field, the order's actual effect of cancelling reserves dedicated to interstate pipelines would impair the authority of the Federal Energy Regulatory Commission to control abandonments of dedicated gas. *See Sunray Mid-Continent Oil Co. v. FPC,* 364 U.S. 137 (1960); *California v. Southland Royalty Co.,* 436 U.S. 519 (1978).

The FERC's authority to regulate an interstate pipeline's purchases of gas is of compelling importance in the specific context of the Kansas Hugoton Field. FERC policy provides for interstate pipelines' purchases of low-cost gas to be "rolled-in" with high-cost gas, such that the average price of gas is consistent with federal policy. *See, e.g., Panhandle Eastern Pipeline Co.,* 34 FERC ¶ 63,055 at 65,190-91 (1986). The loss of low-cost Hugoton reserves dedicated to interstate commerce will impede the FERC's ability to implement this practice. The Hugoton Gas Field is the largest reservoir of cheap gas in the nation. Interstate pipelines' purchasing practices in the Hugoton Gas Field are the subject of intense FERC scrutiny. *See, e.g., Northwest Central Pipeline Corp.,*

33 FERC ¶ 63,067 at 65,275 and 65,278 (1985), wherein it is stated, "It was reasonable for Northwest to expect that over the short-term taking more Arkla gas and *less lower cost Hugoton gas* would reduce Northwest's higher cost take-or-pay obligations, would keep Northwest's gas costs lower over a longer period by preserving more low-cost supplies for later use, and in the long-term would improve Northwest's competitive posture in acquiring future gas supplies and in pricing those supplies competitively. All these outcomes will benefit Northwest's customers. . . ." *Id.* at 65,278 (emphasis added). FERC policy is inconsistent with the Commission's attempt to force interstate pipelines to take more Kansas Hugoton gas. The Commission's order, if allowed to stand, will deprive the FERC of its role in regulating the rate at which Hugoton gas is mixed into the stream of interstate commerce.

CONCLUSION

Northwest Central requests the Court to deny the Motion to Affirm or Dismiss and to note probable jurisdiction.

Respectfully submitted,

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BRIEF

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APPELLANT'S REPLY TO BRIEF OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

Appellant, Northwest Central Pipeline Corporation, submits the following brief in reply to the Brief for the United States and the Federal Energy Regulatory Commission as Amici Curiae.

DISCUSSION

1. The Kansas Supreme Court has taken irreconcilably inconsistent positions in this case. The Court has stated that the amendment to paragraph (p) is not unlawful as an interference with federal regulatory authority because the regulation is not "directed to" pipelines (J.S. 40a). The Court has also stated, however, that the amendment to paragraph (p) is lawful as a correlative rights measure under state law solely *because* interstate pipelines will be coerced into taking higher-than-desired volumes of Kansas gas and that inequities in volume balances among producers will thereby be avoided (J.S. 37a).[1] When a regulation is lawful under state law solely *because* it will coerce interstate pipelines to alter their purchasing practices, it cannot honestly be said that the regulation is *not* "directed to" purchasers. *See* J.S. 50a (Schroeder, C. J., dissenting). A regulation can be "directed to" pipelines even though an indirect route is chosen to get there.

The FERC has compounded and further muddled the confusion commenced in the court below. The FERC mistakenly believes that it has discerned "a crucial

[1] The Kansas Supreme Court has justified its holding that the paragraph (p) amendment is a correlative rights measure by reasoning that, "under ideal circumstances," the "incentive for production by permanently cancelling underages" will "persuade the [pipeline] purchasers to take enough additional gas to acquire an overproduced state in time to avoid permanent cancellation of underages." J.S. at 37a.

distinction" between *Northern Natural*[2] and the "indirect" regulation of those same pipelines in the present case. The "crucial distinction," as described by the FERC, is that, unlike in *Northern Natural*, the coercive effect of the state rule on interstate pipelines in the present case "is a result not of a state order applicable directly to them, but of economic considerations." Govt. Br. at 12.

Since pipelines cannot be put in jail, it is difficult to fathom what type of pressure can be exercised against them other than "economic" pressure. The government's brief provides absolutely no support for its proposition that indirect, but intentional, "economic" pressure is either less effective or less constitutionally objectionable than would be direct "economic" pressure in the form of fines or sanctions such as was proscribed in *Northern Natural*. No one could seriously suggest that a "direct" regulation, noncompliance with which would cause a $500 a day fine (*See* Kan. Stat. Ann. § 55-708), is constitutionally different for preemption purposes from an "indirect" regulation, noncompliance with which would cause "economic" losses of far more than $500 per day. Economic coercion is being applied in both cases to achieve an interference with the federal regulatory scheme.

The amendment to paragraph (p) is quite simply a continuation of the decades-long struggle of the Kansas

[2] *Northern Natural Gas Co. v. State Corp. Comm'n*, 372 U.S. 84 (1963).

Corporation Commission to control the purchasing decisions of interstate pipelines in the Hugoton Field. *Northern Natural* was a part of this same struggle. This case is *Northern Natural* in sheep's clothing.

2. Although its position on the first appeal in this case supports the position that the challenged Kansas rule cannot stand (*see* Govt. Br. 13-14 n.11), the FERC now suggests that the rule is not an "obstacle" to the federal regulatory scheme. The FERC's schizophrenic position not only ignores their own prior brief in this case, it also ignores the FERC's decision concerning *exactly* the question whether federal policy favors greater or lesser purchases of Hugoton gas by Northwest Central.

The policy of the Kansas Corporation Commission is to encourage increased production from the Hugoton Field. The amendment to paragraph (p) is intended to achieve that State policy by making economically prohibitive a decision by a pipeline to spread its takes from the Hugoton Field over a longer term than that deemed desirable by the Kansas Corporation Commission.

Federal policy, on the other hand, is better served when a pipeline is permitted, when it is to its customers' benefit, to take Hugoton gas at a more modest rate, preserving for future use the lower-cost Hugoton gas dedicated to interstate commerce. Appellant's purchasing practices in this specific regard have already been addressed and sanctioned by the FERC.

> It was reasonable for Northwest to expect that over the short-term taking more Arkla gas and *less lower cost Hugoton gas* would reduce Northwest's higher cost take-or-pay obligations, would keep Northwest's gas costs lower over a longer period by preserving more low-cost supplies for later use, and in the long-term would improve Northwest's competitive posture in acquiring future gas supplies and in pricing those supplies competitively. All these outcomes will benefit Northwest's customers . . . .

Northwest Central Pipeline Corp., 33 F.E.R.C. ¶ 63,067 (1985) at 65,278 (italics supplied).

Even though the FERC is not expressly authorized to affirmatively dictate to pipelines the rate at which Hugoton Field gas is produced into the interstate market, the FERC *is* empowered to determine whether an interstate pipeline's purchase mix of higher-priced and lower-priced gas is "prudent."[3] Since FERC regulates the purchasing practices of an interstate pipeline, the State of Kansas may not enact rules designed to flood the market with its own gas. "[A] state law whose central purpose is to regulate matters that Congress intended FERC to regulate" is pre-empted. *Schneidewind v. ANR Pipeline Co.*, 56 U.S.L.W. 4249, 4254 (Mar. 22, 1988).

Federal policy encourages the prudent choices that

[3] "[T]he issue is one of managerial discretion, i.e., was Northwest prudent in using sufficient volumes of low-cost gas to reach a competitive price, saving its additional low-cost gas, and then substituting more higher cost gas for which it had more severe take-or-pay obligations?" *Northwest Central Pipeline Corp.*, 33 F.E.R.C. at 65,277. *See, e.g., Office of Consumers' Counsel v. FERC*, 783 F.2d 206 (D.C. Cir. 1986).

Northwest Central has made. Kansas policy stands as an obstacle to the accomplishment of the federal policy. There is thus an "imminent possibility of collision" between the Kansas Corporation Commission's order and the federal scheme of regulation. *Northern Natural Gas Co. v. State Corp. Comm'n*, 372 U.S. 84, 92 (1963).

CONCLUSION

The very fact that the government, in its two briefs in this case, has taken two inconsistent positions as to whether the challenged State rule interferes with federal authority, establishes that a substantial federal question is presented in this case. Probable jurisdiction should be noted.

Respectfully submitted,

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AMICUS CURIAE

BRIEF

No. 86-1856

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In the Supreme Court of the United States

OCTOBER TERM, 1987

NORTHWEST CENTRAL PIPELINE CORPORATION,
APPELLANT

v.

STATE CORPORATION COMMISSION OF
KANSAS, ET AL.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

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QUESTION PRESENTED

Whether an order of the Kansas Corporation Commission, which regulates the quantity of natural gas that may be produced from Kansas gas wells, impermissibly interferes with the federal regulatory scheme established under the Natural Gas Act, 15 U.S.C. 717 *et seq.*, and the Natural Gas Policy Act of 1978, 15 U.S.C. 3301 *et seq.*, or exceeds the State's power under the Commerce Clause of the United States Constitution.

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In the Supreme Court of the United States

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NORTHWEST CENTRAL PIPELINE CORPORATION, APPELLANT

v.

STATE CORPORATION COMMISSION OF KANSAS, ET AL.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

This brief is filed in response to the Court's order inviting the Solicitor General to express the views of the United States.

STATEMENT

1. a. Natural gas within a "field" can migrate underground from underproduced areas to producing areas. It is possible to extract from a single well or group of wells an indefinitely high percentage of the recoverable natural gas in the field, exhausting not only the producing wells but also nonproducing or underproducing wells (J.S. App. 17a-18a). This phenomenon creates problems not only of equity between owners but of waste induced by a race to capture gas ahead of other wells in the same field. In addition, for physical reasons, a gas reservoir may be

wastefully depleted by either over- or underproduction so that otherwise recoverable reserves are lost. *Champlin Refining Co.* v. *Corporation Comm'n*, 286 U.S. 210, 228 (1932).

Kansas, like other gas producing states, has laws "to prevent the inequitable or unfair taking of natural gas" (Kan. Stat. Ann. § 55-703 (1983); J.S. App. 111a-112a), and to prevent "economic waste, underground waste and surface waste" in its production (Kan. Stat. Ann. §§ 55-701, 55-702 (1983); J.S. App. 110a-111a). Pursuant to these statutes, the Kansas Corporation Commission has since 1944 regulated the production of gas in the Hugoton field[1] so that each well may "ultimately produce approximately the amount of gas underlying the lease upon which it is located." Basic Proration Order for the Hugoton Gas Field 12-13 (13 R. 37-38). This is done by fixing maximum monthly gas production rates—called "allowables"—for all wells in the field. The Kansas Commission first sets a monthly gas production ceiling (pegged to an estimate of market demand) for the field as a whole.[2] The regulatory scheme then assigns to the various producers and their

[1] The Hugoton Field extends across portions of Kansas, Oklahoma and Texas. About two thirds of the field is located in Kansas; in 1983, that portion of the field contained more than 4,000 wells (J.S. 3).

[2] In determining market demand, the Kansas Commission must "consider the reasonable current requirements for current consumption and use within and without the state, and such other factors, conditions, or circumstances that would aid in establishing the market demand" (Kan. Stat. Ann. § 55-703 (1983); J.S. App. 112a-113a). The market demand levels are determined twice a year after public hearings. In determining the market demand levels the state commission solicits from pipelines and producers estimates of upcoming gas production needs. While not bound by these estimates, the Kansas Commission uses them as supporting evidence for its analysis.

wells maximum gas production rates set to spread the estimated market demand over all producing wells in proportion to their individual production capabilities.

In actual practice, however, the wells cannot be operated to meet their monthly allowables precisely. A well may be "shut in" and thus underproduce because of mechanical problems or the lack of a willing buyer of the well's gas production; at other times, a well may be overproduced by error or design. To account for under- or overproduction, the Kansas scheme incorporates a system of tolerances. If a well produces less than its allowable level, it accrues an "underage"; an overproducing well accrues an "overage." Overages are offset against future monthly allowables; underages entitle a producer to overproduce his well (*i.e.*, produce in excess of the well's monthly allowable to make up the underage) if there is a purchaser for the extra gas and the well can physically produce it. J.S. App. 17a-20a.

The overall result is a regulatory scheme that seeks to "balance[] various factors in an effort to regulate production so that the amount produced over time from any well is equal to the amount of gas originally in the developed lease" (J.S. App. 17a). The formula, with allowables, underages and overages, relies on the concept of "compensating drainage" so that, while wells may produce different amounts and produce at various times, they are "in balance in the long pull" (*id.* at 18a).

b. In February 1983, the Kansas Commission changed the underage rules to create "an incentive for operators to produce" (J.S. App. 74a). Before the change, accrued underages were subject to cancellation but also to reinstatement under rules whose net effect was that underages could be accrued indefinitely and used at any time. Over time underages accumulated, and by 1983 a

huge amount of underages had been built up.[3] The 1983 changes provided, for the first time, a set of rules under which underages are permanently cancelled if not reinstated and produced within specified periods of years (J.S. App. 20a-21a). By its terms, the rule change was "directed to and affects only those who drill for and produce gas from the Hugoton Field. • • • [It] does not require pipeline[] purchasers to do anything or refrain from doing anything" (*id.* at 87a).

The Kansas Commission's reasons for the rule change were not explained with perfect clarity and are a matter of some dispute. The Kansas Commission stated that the prior rule "does not provide operators sufficient incentive to produce gas" (J.S. App. 74a) and that one purpose of the change was to "encourage" production generally (*id.* at 73a). The Kansas Supreme Court also understood the

[3] For most wells in the Hugoton field, underages have risen dramatically in recent years, reaching a total of over 204 billion cubic feet of gas by 1982 (J.S. App. 74a); the total natural gas production for all of Kansas that year was a little over 430 billion cubic feet (American Gas Association, *Gas Facts: 1984 Data* 28, 29 (1985)). Because of relatively liberal production and sales contracting terms and the higher tolerances for underproduction in the Kansas Hugoton field, pipelines were apparently using the field for "storage" and filling their immediate gas needs elsewhere (J.S. App. 34a). This happened even though the Hugoton field gas is, relatively speaking, low priced gas. (Most of the Hugoton field gas production is committed or dedicated, when produced, to interstate commerce (see note 5, *infra*) and thus commands comparatively low prices under Section 104 of the Natural Gas Policy Act of 1978, 15 U.S.C. 3314.) Appellant is among the pipelines that have chosen to purchase higher-priced gas from other areas and preserve the lower priced Hugoton field gas for later use. See *Northwest Central Pipeline Corp.*, 33 F.E.R.C. ¶ 63,067, at 65,277-65,278 (1985), a case still before FERC involving the prudence of appellant's 1984 gas purchasing practices.

Kansas Commission to have concluded that permitting indefinite accumulation of underages had led "Hugoton Field production [to fall] below good recovery practices and upset the dynamics of the Hugoton Field, affecting both proration and correlative rights" (*id.* at 4a; see *id.* at 11a-12a, 17a-18a).[4] The Kansas Supreme Court did recognize that while directed to gas producers, the rule change was intended to affect pipeline purchasing practices (*id.* at 40a-41a).

2. Together with other interstate pipelines, appellant opposed the rule change before the Kansas Commission in the rulemaking proceeding. It alleged, inter alia, that the proposed rule change would unlawfully encroach upon the federal government's exclusive regulatory jurisdiction under the Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.*[5]

[4] One correlative rights problem was apparently as follows. The formula for monthly allowables for particular wells depends on factors that include pressure of the well (J.S. App. 17a-18a). Operating a well reduces its pressure, so that "operators producing their allowable may [thereafter] • • • receive a smaller allowable than those operators not producing their allowables" (*id.* at 73a). In other words, operators not producing their allowables would not only accumulate underages but would also receive disproportionately high future allowables. One of the Kansas Commission's stated concerns was to adopt provisions that would "induce the production necessary to balance the field and protect correlative rights" (*id.* at 75a).

[5] Most of the natural gas produced from the Kansas-Hugoton gas field is sold to interstate gas pipelines under certificates of public convenience and necessity issued by the Federal Energy Regulatory Commission under Section 7 of the NGA, 15 U.S.C. 717f (J.S. 3-4). This means that the gas, when produced, is dedicated to interstate commerce and producers have a legal duty to sell any gas that they produce to the interstate market until relieved of that obligation by the Commission. Passage of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*, did not relieve producers of that obligation, because that Act provides that gas dedicated to interstate commerce before the NGPA was enacted generally remains under the Commis-

More particularly, relying on this Court's decision in *Northern Natural Gas Co.* v. *State Corporation Comm'n*, 372 U.S. 84 (1963), appellant argued that the threat to cancel underages if they were not used within a specified period of years would force it to purchase more Kansas gas at a time when it did not need the gas (or else risk permanently losing gas from a well whose production was contractually committed to it), and therefore that the state was in effect directing interstate pipeline purchasing practices, a matter exclusively within the concern of the Federal Energy Regulatory Commission.

After the Kansas Commission rejected these contentions, appellant sought judicial review of the new rule. A Kansas district court upheld the rule change (J.S. App. 53a-60a) on the ground that it involved the "production or gathering" of gas, activities specifically excluded from the reach of federal regulation by Section 1(b) of the NGA, 15 U.S.C. 717(b).[6]

A divided Kansas Supreme Court affirmed (J.S. App. 13a-44a). While recognizing that the new rule was an "indirect effort to influence purchasers" and acknowledging that "purchasers are indirectly caught in the backwash," the court upheld the rule against the challenge based on *Northern Natural* because the "rules on underages are a part of production regulation" over which the state has

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sion's NGA certification authority (15 U.S.C. 3431(a)(1)(A) and (B)).

[6] That section provides in pertinent part:

> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas * * * and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas * * * or to the production or gathering of natural gas.

exclusive jurisdiction (J.S. App. 40a-41a). In dissent, Chief Judge Schroeder took the view that the rule is invalid, either on the ground that the Kansas Commission had exceeded its "statutory authority in fixing allowables far in excess of demand" (*id.* at 45a) or, alternatively, because the state regulation violated *Northern Natural*: while "directed at producers not purchasers, its real purpose is to create an impact on purchasers' business decisions concerning the makeup of their interstate gas mix" and therefore its effect is to impair the regulatory authority of the Commission under the NGA (J.S. App. 46a-48a).

Appellant appealed that decision to this Court. On February 24, 1986, after deciding *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd. (Transco)*, 474 U.S. 409, the Court vacated the Kansas Supreme Court judgment and remanded the matter for further consideration in light of that case.[7] 475 U.S. 1002 (1986).

3. On remand, the Kansas Supreme Court, with Chief Judge Schroeder again dissenting, reaffirmed its earlier decision (J.S. App. 1a-12a). In doing so, the majority read *Transco* as requiring a determination whether the state's order "falls within the limits of a comprehensive federal regulatory scheme rather than within the category of

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[7] *Transco* dealt with the question whether Congress, in enacting the NGPA, had so altered the federal regulatory scheme that state regulations preempted under *Northern Natural* could now be permitted. The Court held it had not: "[A]lthough FERC may now possess less regulatory jurisdiction over the 'intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States,' *Northern Natural*, 372 U.S. at 92, than it did under the old [pre-NGPA] regime, that relationship is still a subject of deep federal concern" (474 U.S. at 422). The Court in *Transco* went on to find that a state's attempt to regulate the wellhead purchasing practices of interstate pipelines directly was no more valid in the post-NGPA environment than under *Northern Natural* before the NGPA was passed (*id.* at 422-424).

regulatory questions reserved for the states; and, if so, whether the effect of the order will be to impair market forces" (*id.* at 8a-9a). Although finding that "any change in rates of production," such as that contemplated by the state's action in tightening the underage rules "has an effect on the interstate market" (*id.* at 11a), the Kansas court found this alone was not sufficient to preempt the state action. Rather, it concluded that the key test must be "whether the regulation is primarily directed at the marketing of gas rather than production thereof" (*ibid.*). On this basis, the Court upheld the Kansas Commission's rule change (J.S. App. 11a-12a):

> Here, the Commission found the amendment * * * was necessary for the prevention of waste and protection of correlative rights. Though controverted, there is evidence in the record to support that finding. Further, any effect on the interstate sale of gas is merely incidental rather than the objective of the order.

The Kansas court consequently held that the order "does not transgress federal regulation of natural gas in interstate commerce" and affirmed the state commission (*id.* at 12a).

DISCUSSION

We believe that the Supreme Court of Kansas reached the correct result: the state commission order at issue in this case is not preempted by the Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.*, or the Natural Gas Policy Act (NGPA), 15 U.S.C. 3301 *et seq.* While the issues are complex, and we are not able to endorse all of the state court's reasoning, we do not believe that appellant's contentions warrant this Court's plenary consideration.

Unlike the state orders at issue in *Northern Natural* and *Transco*, the state order at issue here was, on its face,

directed at *producers*, not at purchasers of gas from producers for resale in interstate commerce. Compare *Northern Natural*, 372 U.S. at 90; *Transco*, 474 U.S. at 411. While a state order nominally directed at gas producers may conflict with the comprehensive scheme of federal regulation of gas purchasers, the Kansas proration order does not conflict with the federal scheme merely because, like many other state regulations of in-state production activities, it has a forseeable effect on the economic choices made by gas purchasers and hence on the flow of the product into interstate commerce. Purchasers are not, by the order, compelled even indirectly to act contrary to federal regulation, nor is the federal scheme required to give way before the state's rule change.

1. In *Northern Natural Gas Co.* v. *State Corporation Comm'n*, 372 U.S. 84 (1963), the Court ruled that a Kansas "ratable-take" order, requiring an interstate pipeline to purchase gas ratably from all wells connected to its pipeline system in each gas field within the state, was preempted by the NGA because the order encroached on the exclusive regulatory jurisdiction conferred on the Federal Power Commission by that statute. In reaching that conclusion, the Court stressed two points.

First, the Court stressed that the state order at issue in *Northern Natural* was "unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce" (372 U.S. at 92 (emphasis in original)). The fact that the order imposed direct obligations on gas purchasers was noted first (*id.* at 90) as the reason why the "production or gathering" exemption set forth in Section 1(b) of the NGA, 15 U.S.C. 717(b), did not render that Act inapplicable and hence clear the way for state regulation.[8] The Court emphasized

[8] The Court expressly declined to consider "the effect of the 'production or gathering' exemption upon ratable-take orders directed

the point again in explaining the nature of the "danger of interference with the federal regulatory scheme" (372 U.S. at 92) and yet again in explaining (*id.* at 93-94) why the state order was not an acceptable means of achieving the concededly legitimate state objective of conserving natural resources.[9]

Second, the Court stressed that "collision between the state and federal regulation" was an "imminent possibility" and that the orders must therefore "be declared a nullity in order to assure the effectuation of the comprehensive federal regulation ordained by Congress" (372 U.S. at 92). As the Court explained (*id.* at 89; see also *id.* at 98 (Harlan, J., dissenting)), the ratable-take requirement threatened the pipelines with criminal penalties if they did not either reduce their takes from wells with which they had contracts, thus incurring liability to those producers, or increase their takes from other wells, and thus take more gas than they could currently use. Any such "readjustment of purchasing patterns * * * could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States" (*id.* at 92).

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exclusively at independent producers of natural gas" (372 U.S. at 90 n.8).

[9] The state court in *Northern Natural* had sustained the state orders because they did not involve direct regulation of the prices of wholesales of natural gas. This Court rejected that argument (see 372 U.S. at 90-91), saying that the "federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas * * * or for state regulations which would indirectly achieve the same result" (*id.* at 91 (footnote omitted)). The effect of the ratable-take orders at issue in *Northern Natural* was "indirect," however, only in the sense that the orders purported to regulate quantity and not price, not in the sense that they purported to regulate a person other than the purchaser-wholesaler of gas.

In *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd.*, 474 U.S. 409 (1986), the Court was confronted with a ratable-take order "virtually identical" (*id.* at 411) to the order struck down in *Northern Natural*. In the interim, however, Congress had enacted the NGPA, which restructured the comprehensive NGA regulatory scheme, sharply reducing FERC authority to set wellhead prices and to dedicate natural gas production to the interstate market and circumscribing its review of interstate pipeline purchasing behavior. See generally *Transco*, 474 U.S. at 422-423. The question in *Transco*, therefore, was whether the rule of *Northern Natural* survived the enactment of the NGPA. The Court answered that question in the affirmative. It did so, as we read the Court's opinion, in essence because it found that the NGPA had not eliminated the NGA's comprehensive federal regulatory scheme but had incorporated into that scheme a new element—a federal decision "to leave determination of supply and first-sale price to the market" (*Transco*, 474 U.S. at 422); the state order at issue in *Transco*, by requiring pipeline purchasers to take gas ratably, conflicted with the NGPA policy that there should be no regulation of the pipeline wellhead purchases at issue there, and hence was invalid.[10]

2. The present case, unlike both *Northern Natural* and *Transco*, involves a regulation that is, in terms, directed at producers of natural gas, not at pipelines. To be sure, the Kansas regulation, as the Kansas Supreme Court itself recognized, is "intended for purchasers [even though] directed to producers" (J.S. App. 40a). It is intended to increase production from the Hugoton field; as the court

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[10] In contrast to the gas involved in *Transco*, the current case involves gas committed to the interstate market under the NGA, which remains subject to ceiling prices set by Congress (15 U.S.C. 3314). See note 5, *supra*.

recognized, that result depends in large part on pipelines being persuaded to take additional gas rather than to allow the cancellation of underages (J.S. App. 37a):

> The weight and logic of the evidence raises serious questions of the producers' ability to persuade the purchasers to take enough additional gas to acquire an overproduced state in time to avoid permanent cancellation of underages. However, there is substantial competent evidence in the record indicating otherwise under ideal circumstances.

But any impact on pipelines is a result not of a state order applicable directly to them, but of economic considerations.

This is a crucial distinction for the preemption analysis. As the Court summarized most recently in *Schneidewind* v. *ANR Pipeline Co.*, No. 86-986 (Mar. 22, 1988), slip op. 6, a state regulation that is not explicitly barred by federal law may nevertheless be preempted if Congress has "indicate[d] an intent to occupy a given field to the exclusion of state law" and the state regulation lies within that field. And state regulation that lies outside any field where Congress has entirely displaced state regulation may be preempted " 'when it is impossible to comply with both state and federal law, *Florida Lime & Avocado Growers, Inc.* v. *Paul*, 373 U.S. 132, 142-143 (1963), or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress, *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941).' " *Schneidewind*, slip op. 6 (quoting *California Coastal Comm'n* v. *Granite Rock Co.*, No. 85-1200 (Mar. 24, 1987), slip op. 7).

The significance, for preemption analysis, of the fact that the Kansas order at issue here (unlike the state regulations at issue in *Northern Natural*, *Transco*, and *Schneidewind*) by its terms regulates producers, and gas production, not pipelines and their activities, is that the "field occupation" sort of preemption is not applicable. Cf. *Schneidewind*, slip op. 1-2 & n. 1. The Kansas order directly regulates the quantities of natural gas that may be produced from a given well in particular periods, and the NGA has since the beginning exempted from the federal regulatory domain the regulation of "production or gathering" of natural gas. See *Northern Natural*, 372 U.S. at 89; *Interstate Natural Gas Co.* v. *FPC*, 331 U.S. 682, 690 (1947). The Kansas order cannot, therefore, be said to have intruded on a domain occupied by federal law to the exclusion of state law.

Unlike the state court, however, we do not think the matter ends there.[11] The Kansas order would also be preempted if it could be shown to conflict with the federal

---

[11] Both in its initial opinion (J.S. App. 40a-41a) and after remand from this Court (*id.* at 11a), the state court saw essentially a bright line between a state regulation addressed to gas producers and a regulation addressed to gas purchasers. Finding (*id.* at 11a-12a) that the Kansas order here was not "primarily directed at the marketing of gas [but at the] production thereof," it ruled that the state order was not barred by the federal scheme.

As we said in *Northwest Central Pipeline I* (85-182 Br. 8), we do not think the purposes underlying preemption in this area permit such a simple, "bright-line" analysis. As Justice Harlan pointed out in his dissent in *Northern Natural*, "[t]he production of natural gas and its movement into interstate channels constitute one and the same physical operation" (372 U.S. at 100). Particularly since the relationship between producers and pipelines has been characterized by long-term contracts covering the entire production of given wells, conflict with the federal regulatory scheme is not necessarily avoided by making the nominal target of state regulation the producer rather than the pipeline. The fact that a rule applies directly to producers rather than purchasers does not automatically eliminate the possibility that it "could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers

scheme, either in the *Paul* sense or in the *Davidowitz* sense, and the fact that the Kansas order is nominally aimed at producers does not eliminate the possibility of such a conflict. See *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 583-584 (1981). A pipeline claiming "conflict" preemption, however, has the burden of showing the conflict. It is this burden that in our view appellant has not met.

Here, contrary to appellant's argument (J.S. 21-22), there is no possibility of actual "collision" between state and federal law in the *Paul* sense. As the cases make clear, federal authority extends to regulating the sale and transportation of natural gas in interstate commerce; while the Commission's abandonment authority extends to insuring that gas that *is* produced from committed or dedicated leases and wells moves in interstate commerce (see, *e.g.*, *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979)), the Commission has no authority to compel gas production (see *Shell Oil Co.* v. *FERC*, 566 F.2d 536 (5th Cir. 1978), aff'd by an equally divided Court, 440 U.S. 192 (1979)), and a pipeline and its customers therefore have no federally enforceable right to require that gas be produced or that it be protected for future purchase.

3. Contrary to appellant's argument (J.S. 17, 20-21), otherwise valid state regulation does not pose an

---

in other States" (*Northern Natural*, 372 U.S. at 92; see *Transco*, 474 U.S. at 420, 422).

But we have concluded that we spoke too quickly when we suggested in *Northwest Central Pipeline I* (85-182 Br. 9-10) that if pipelines would be induced by the threat of losing gas to increase their takes from Kansas gas fields, and if the rule of *Northern Natural* were held in *Transco* to have survived the enactment of the NGPA, then the Kansas order could not stand. As *Schneidewind* makes clear, it remains necessary to examine the federal scheme to determine whether there is an actual conflict between federal and state law.

"obstacle," in the *Davidowitz* sense, to the accomplishment of the purposes of federal law simply because it foreseeably—even intentionally—affects pipeline purchasing practices. Those practices are not themselves sacrosanct, and nothing in this Court's prior cases indicates that the federal regulatory scheme preempts every state law rule that influences pipeline purchasing decisions; to the contrary, the federal regulatory scheme presupposes state-fixed production and gathering regulations just as it presupposes other property and contract rights and other conditions dependent on state law. See pages 16-17, *infra*.

All agree that the rights of well owners to the gas in a common field are determined by state law (see, *e.g.*, *Thompson* v. *Consolidated Gas Utilities Corp.*, 300 U.S. 55, 69-70 (1937); *Champlin Refining Co.* v. *Corporation Comm'n*, 286 U.S. 210 (1932); see also *Northern Natural*, 372 U.S. at 94-95 & n. 12); this determination presents "as thorny a problem as has challenged the ingenuity and wisdom of legislatures." *Railroad Comm'n* v. *Rowan & Nichols Oil Co.*, 310 U.S. 573, 579 (1940)). Different possible state rules bear different relationships to the market forces that determine the price of gas. The "rule of capture," under which gas belongs to the well owner who extracts it, spurs each well owner to take gas quickly (as long as the price covers the cost of extraction). See generally 1 W. L. Summers, *The Law of Oil and Gas* §§ 61-63 (perm. ed. 1954); Hardwicke, *The Rule of Capture and Its Implications as Applied to Oil and Gas*, 13 Tex. L. Rev. 391 (1935). As appellant itself noted (J.S. 4-5), in order to prevent resulting waste and protect correlative rights, Kansas, like other states, has modified the rule of capture by enacting its system of allowables. If the result of a system of allowables were to fix, in advance and permanently, a quantity of gas that each well owner may

take from the pool over as long a period of he wishes, then the fact that his well is drilled into a common pool would give the owner no incentive to extract gas any faster than the market otherwise warrants.[12]

Appellant's argument, as we understand it, is that the combined result of the NGA, the NGPA and *Transco* is to require Kansas to adopt, or at least approximate, such a fixed-entitlement system of allowables, eliminating as far as possible any common-pool incentive for producers to take gas faster than they otherwise would. As we read appellant's contentions, any state scheme of allowables that has the intended effect of giving a well connected to an interstate pipeline a use-it-or-lose-it incentive to extract gas should be deemed an impermissible "obstacle" to accomplishment of the purposes of federal regulation.

We disagree. As the "production or gathering" exemption of Section 1(b) of the NGA, 15 U.S.C. 717(b) makes clear, the federal scheme recognizes not only that federal jurisdiction does not extend to the regulation of gas production, but that state authority does. Appellant offers no evidence of a congressional intent to intrude on traditional, otherwise valid state regulation of production merely because it may affect pipelines' economic choices among purchasing alternatives all of which are permitted by their contracts and the federal regulatory scheme. See 124 Cong. Rec. 38366 (1978) (remarks of Rep. Dingell, House Manager of the NGPA, explaining that state authority to prorate production is unaffected by NGPA). There is no intrusion upon the "comprehensive * * * federal regulatory authority over interstate gas transactions" (*Schneidewind*, slip op. 7 n.6), unless state regulation does more than influence the choices pipelines make among lawfully available actions.[13]

[12] Because of inherent uncertainties about the quantity of recoverable gas in the ground, no system of allowables can exactly fix total entitlements for all time.

The situation might be different if there were no valid state reasons for the Kansas order, but appellant does not, as we understand its position, argue in this Court that the Kansas order has been " 'shown to bear no reasonable relation either to the prevention of waste or the protection of correlative rights.' " *Thompson* v. *Consolidated Gas Utilities Corp.*, 300 U.S. 55, 69 (1937) (quoted in *Northern Natural*, 372 U.S. at 95 n.12). The Kansas commission concluded here (albeit not with exceptional clarity) that permitting each well owner to accumulate underages indefinitely will cause waste and be unfair to the wells that do produce their monthly allowables. See J.S. App. 73a. The Kansas Supreme Court affirmed that finding (*id.* at 11a-12a):

> Here, the Commission found that the amendment to paragraph (p) of the basic proration order was neces-

[13] The Court in *Transco* noted (474 U.S. at 420) that *Northern Natural* held ratable-take provisions preempted in part because they eliminated the pipeline's ability to "choose a different * * * purchasing pattern." The state regulation at issue here does not preclude pipeline choices. Although it attempts to influence them, neither *Northern Natural* nor *Transco* suggest that this is an impermissible state objective.

Nor does the Kansas order trespass upon Congress's decision "to leave determination of supply and first-sale price to the market" (*Transco*, 474 U.S. at 422). The dissent in *Transco* noted (*id.* at 435 n.6): "While the congressional desire to *de*control prices uniformly throughout the Nation includes an intent to prevent States from enacting regulation to *re*control them, it does not imply an intent either to create an anarchistic regulatory gap free from property rights and contract rules, or to create a national law of contracts to govern natural gas relationships." The majority did not disagree with this overall view; it simply found that the NGPA had not significantly altered the comprehensive federal regulatory scheme that led to the "field occupation" preemption analysis in *Northern Natural*.

sary for the prevention of waste and protection of correlative rights. Though controverted, there is evidence in the record to support that finding.

The ratable-take orders at issue in *Northern Natural* and *Transco* were of course also defended on grounds of conservation and fairness among well owners in a common pool (372 U.S. at 93; 474 U.S. at 416), and this Court in both cases, without disputing the state's proffered justification, held the orders nevertheless preempted by federal law. But in those cases the state justification was proffered as a reason for overriding federal regulation. It is one thing to say that the federal scheme precludes direct state regulation of pipeline takes even if the state proffers an otherwise valid justification; it is a different thing entirely to say that the federal scheme precludes a state from adjusting its system of producer allowables, in a manner it deems appropriate to prevent waste and protect correlative rights, because of the effect on the pipelines' purchasing choices through the operation of market forces.

In sum, our view is as follows. *Transco* establishes that state regulation of pipeline takes, as such, continues to be barred under the NGPA, as it was under the NGA. State regulation of producers is, however, a different matter. Such regulation may be invalid if it is " 'shown to bear no reasonable relation either to the prevention of waste or the protection of correlative rights' " (*Northern Natural*, 372 U.S. at 95 n.12 (quoting *Thompson* v. *Consolidated Gas Utilities Corp.*, 300 U.S. at 69)), and it is possible that even state regulation serving such purposes might be shown to conflict with the aims of the federal scheme. But such a showing would require more than a demonstration that the state regulation foreseeably affects the choices pipelines in fact make: otherwise valid state regulation of

production does not inherently conflict with the federal regulation of pipeline activities; it is instead one of the conditions under which those activities operate.

4. Appellant's Commerce Clause argument, to the extent that it differs from appellant's argument based on preemption, is based on a misconception. The argument is that the "effect of the [Kansas] order will be to withdraw a large volume of low-cost natural gas from the established stream of interstate commerce to benefit preferentially the customers of the local intrastate gas companies" (J.S. 24-25). But as we have noted, see page 14 a particular quantity of gas is not in the stream of interstate commerce until it is sold or produced, and an interstate pipeline that has contracted to purchase the production of a particular well does not have a right, under the Commerce Clause or otherwise, to be protected against otherwise valid state rules that reduce that well's production. Cf. *Cities Service Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179, 186-189 (1950).

CONCLUSION

The appeal should be dismissed for lack of a substantial federal question.

Respectfully submitted.

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JOINT

APPENDIX

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No. 86-1856

In The Supreme Court Of The United States

October Term, 1987

Northwest Central Pipeline Corporation,
Appellant,

vs.

State Corporation Commission of the State of Kansas, *et al.*,
Appellees.

ON APPEAL AFTER REMAND TO
THE SUPREME COURT OF KANSAS

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No. 86-1856

In The Supreme Court Of The United States

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Appellees.

ON APPEAL AFTER REMAND TO
THE SUPREME COURT OF KANSAS

JOINT APPENDIX

RELEVANT DOCKET ENTRIES

In the State Corporation Commission of the
State of Kansas
Docket No. C-164

In the Matter of Establishing Rules and Regulations
Relating to the Production, Sale and Conservation
of Natural Gas in the Hugoton Field

Date	Vol./No.	Filings/Proceedings
3/21/44	1/B	Commission enters Basic Proration Order for Hugoton Gas Field
9/17/82	1/A	Commission enters Order setting hearing on policy concerning underproduction and overproduction of gas from the Hugoton Gas Field and the reinstatement of cancelled underage
11/3-4/82	9, 10	Commission holds hearing on the question of production and underages
12/10/82	1/H	Appellant files brief on federal constitutional issues
2/16/83	1/C	Commission enters Order amending Paragraph (p) of Basic Proration Order
2/28/83	11/A	Appellant files Petition for Rehearing
3/4/83	1/D	Commission grants rehearing limited to consideration of oral argument
3/17/83	12	Commission holds rehearing
4/18/83	1/E	Commission enters Order modifying Order of February 16, 1983, and rejecting federal constitutional claims

IN THE DISTRICT COURT OF GRAY COUNTY
STATE OF KANSAS
Case No. 83-C-22

Northern Natural Gas Company, *et al.* v.
The State Corporation Commission
of the State of Kansas, *et al.*

Date	Vol./Page	Filings/Proceedings
5/16/83	13/88	Appellant files Petition for Judicial Review
10/27/83	13/595	Appellant files Requested Findings of Fact
10/27/83	13/630	Commission files Suggested Findings of Fact
1/3/84	13/643	District Court enters Journal Entry of Judgement affirming Commission orders

IN THE SUPREME COURT OF
THE STATE OF KANSAS
No. 84-56917-S

Northwest Central Pipeline Corporation, *et al.*
v. The State Corporation Commission of the
State of Kansas, *et al.*

Date	Filings/Proceedings
9/28/84	Appellant files brief on appeal
12/6/84	Commission files response brief
12/26/84	Appellant files reply brief
2/28/85	Argument

5/10/85	Opinion filed, affirming judgment of district court
6/7/85	Mandate issued
7/8/85	Appellant files Notice of Appeal to the Supreme Court of the United States

IN THE SUPREME COURT OF
THE UNITED STATES

No. 85-182

[Caption Omitted]

Date	No.	Filings/Proceedings
8/5/85	1	Jurisdictional Statement filed
8/30/85	2	Motion to Affirm or Dismiss filed by Commission
10/7/85	4	Court invites Solicitor General to file brief expressing views of the United States
1/17/86	6	United States and Federal Energy Regulatory Commission file brief as Amici Curiae in support of jurisdiction
2/11/86	8	Commission files Brief in Response to the Brief of the United States
2/24/86	9	Judgment vacated and case remanded to the Supreme Court of Kansas for further consideration
3/26/86	10	Mandate issues to Supreme Court of Kansas

IN THE SUPREME COURT OF
THE STATE OF KANSAS

No. 84-56917-S

[Caption Omitted]

Date	Filings/Proceedings
4/4/86	Commission files Motion to Remand for Further Consideration by Appellee State Corporation Commission
4/15/86	Court sets briefing schedule and denies motion to remand
5/19/86	Appellant files Brief in Support of Reversal on Remand from United States Supreme Court
7/7/86	Commission files brief in support of affirmance
7/31/86	Appellant files reply brief
12/3/86	Argument
2/20/87	Opinion filed, affirming judgment of district court
3/20/87	Mandate issued
3/26/87	Appellant files Notice of Appeal to the Supreme Court of the United States

IN THE SUPREME COURT OF
THE UNITED STATES

No. 86-1856

[Caption Omitted]

Date	No.	Filings/Proceedings
5/21/87	1	Jurisdictional Statement filed
6/22/87	2	Commission files Motion to Affirm or Dismiss

9/18/87	4	Appellant files Brief Opposing Motion to Affirm or Dismiss
10/5/87	5	Solicitor General invited to file brief expressing views of the United States
4/13/88	6	United States and Federal Energy Regulatory Commission file brief as Amici Curiae opposing jurisdiction
4/27/88	8	Appellant files Reply to Brief of the United States
5/23/88	10	Probable jurisdiction noted

Before the State Corporation Commission
of the State of Kansas

Docket No. C-164
Conservation Division
Order No. 44-3-21

In the Matter of Establishing Rules and Regulations relating to the production, sale and conservation of natural gas in the Hugoton Field of Kearny, Finney, Grant, Haskell, Morton, Stevens, Seward, Stanton, and Hamilton Counties, Kansas.[1]

1. As amended by order dated October 13, 1948.

BASIC PRORATION ORDER

Now on this 21st day of March, 1944, this matter comes on for consideration and determination upon the investigation instituted by the Commission to determine whether the provisions of the Basic Order herein, as issued on October 28, 1942, should be changed, modified, or amended; and the Commission, having heard the evidence at its hearing held at Wichita, Kansas, on September 28, 1943, having concluded its investigation, and being fully advised in the premises, finds that certain further additional facts have been ascertained concerning the Hugoton Gas Field and the proper method which should be used in fixing well quotas to the end that each developed lease will be enabled to currently produce its daily allowable so that ultimately such developed lease will have an opportunity to produce approximately the amount of gas which underlies such lease; that in order to properly carry out the intent of the statutes of the State of Kansas relating to the conservation of natural gas, that the Basic Proration Order for the Hugoton Gas Field, dated October 28, 1942, should be rescinded and superseded by a new Basic Order; that in connection with such new Basic Order, and based upon the evidence before it, the Commission finds:

(a) That the Hugoton Field is a common source of supply of natural gas located in Kearny, Finney, Grant, Haskell, Morton, Stevens, Seward, Stanton and Hamilton Counties, Kansas.[2] The field extends south to the Kansas-Oklahoma state line and into the Oklahoma Panhandle. The exact boundaries of the field in Kansas are not definitely established due to the lack of sufficient development. It is indicated by present development

2. As amended by order dated October 13, 1948.

that the Kansas portion of the field is sixty-five miles long and forty miles wide. Approximately 4,014 commercial gas wells have been drilled in said field and over 350,000,000,000 cubic feet of gas have been withdrawn from the common reservoir. The wells have a daily average open-flow in excess of 750,000 cubic feet and the total combined deliverability of all the wells is approximately 35,877,782,000 cubic feet daily. The presently developed acreage held by production totals 2,549,339 acres.

(b) That the market demand for gas produced in the Hugoton Field in Kansas is approximately 1,434,000,000 cubic feet daily and it is therefore evident that the available production of the wells is in excess of the market demand for gas produced from the common source of supply, notwithstanding that said wells are produced at not to exceed twenty-five percent of their open-flow capacities. One hundred and eighty-eight of the wells are located on 640-acre tracts while eighty-four wells are on 160-acre locations. Since 1936, practically all of the drilling has occurred upon 640-acre tracts and, insofar as present and future drilling is concerned, 640 acres appears to be the standard drilling unit. Localized drilling or development has occurred in several portions of the field but it is not, however, wholly concentrated in any one particular area.

(c) That gas is found in porous limestone and dolomite and is encountered at an average depth of from 2,700 to 2,800 feet below the surface. Impervious shale bodies are encountered within the producing horizons throughout the field, but it is evident that the gas producing formations are interconnected and therefore constitute one common source of supply. The thickness of the gas-producing horizons or zones varies considerably, although a sand thickness of from fifty to seventy-five feet is representative of the geological conditions

existing generally throughout the field. A fair average porosity for limestone bodies such as are encountered in the Hugoton Field is 18.2 percent. The number of gas-producing horizons, as shown by the well logs or drill cuttings, varies between wells and tracts, most of them containing from three to five gas-producing zones.

(d) That the virgin shut-in wellhead pressure was 435 pounds per square inch, while, at the present time, shut-in wellhead pressures have been observed as low as 371 pounds. Likewise, variations in the pressures as between wells and leases exist throughout the field. The movement of gas within a common reservoir is governed by pressure differentials; the gas migrates from the areas of higher pressure to the areas of lower pressure. In its virgin state, the pressure within a common source of supply is the same, or practically the same at all points. When gas is produced from a well, the pressure within the reservoir is produced in the vicinity of the well bore. This causes gas in the formation to expand into the well. When a producing well is shut in, the pressure in the formation in the vicinity of the well will build up from that existing during production and this again tends to equalize the pressure within the formation and demonstrates that the continued migration of gas from high pressure to low pressure areas is occurring. Gas migrates within the reservoir from developed leases having higher pressures to other developed leases having lower pressures in accordance with the same principles which govern the movement of gas from the formation into the several well bores. If the migration or drainage of gas across property lines is not equalized by counter-drainage, the developed leases so drained will not ultimately produce approximately the amount of gas underlying them, either at the time the wells were drilled thereon or at the time this order becomes effective. The extent of the movement or drainage of gas between developed leases depends

upon the magnitude of variation in pressures existing as between developed leases, the areas contained in such leases and the amounts of gas withdrawn.

(e) That the evidence demonstrates that pressure differentials or gradients exist within the reservoir and between developed leases located sufficiently close to each other to cause drainage between such leases. The shut-in wellhead pressures of some of the said unconnected wells have decreased since they were originally tested, even though the said wells have not produced any gas. Since pressure is one of the measurements of the amounts of gas within the reservoir, the decreases in pressure within the reservoir under leases containing wells have produced no gas show that gas has been drained from such leases to or toward other developed leases, having pipeline connections in greater quantities than it has moved to said leases. Therefore, uncompensated, cognizable and undue drainage as occurred within the common source of supply and between developed leases therein.

(f) That since there exists disproportionate production from the wells and leases in said field which impairs the correlative rights of many of the owners of developed leases, it is necessary for the Commission to take jurisdiction and to prescribe regulations for the production of gas from said wells and others that may be hereafter completed in said field to the end that each person, firm, or corporation having the right to drill into and produce natural gas from said field may take therefrom only such proportion of the amount that may be produced therefrom without waste as will permit each well or developed lease to produce ultimately at least approximately the amount of gas underlying the land or lease on which such well is located and currently produce proportionately with the other wells in said field. That the said disproportionate production which has occurred and is occurring

has caused undue, cognizable, preventable and non-compensated drainage of gas from developed properties, tracts and leases to other developed properties, tracts and leases in and throughout said field; that various developed properties have suffered undue, premature and inequitable depletion by reason of such conditions and practices, as is evidenced by the differences in the shut-in wellhead pressure of the various wells throughout the field. The wells which have produced the greater amounts of gas generally show the lower pressures, while the wells which have had smaller withdrawals generally show the higher pressures. Wherever this is not true, the fact that wells, which have produced considerable quantities of gas, have not suffered material decreases in pressure, indicates that they have probably drained adjoining leases to a greater extent than the wells which show pressure declines. The present and past production from the wells in said field is and has been inequitable and unfair and has caused unreasonable discrimination against various developed properties, denying to many owners of developed properties the opportunity to produce currently and proportionately with the owners of other wells in said field, and denying to many owners of developed properties the opportunity to ultimately produce at least approximately the amount of gas underlying their developed tracts.

(g)[3 & 4] That one well completed in said formation can adequately and sufficiently drain 640 acres without causing waste, and considering the cost of drilling, equipping and operating one well in comparison with the estimated recovery per acre and the slow rate at which the production for said field can be ratably and

3. As amended by order dated February 18, 1965.
4. As amended by order dated January 25, 1973.

nonwastefully marketed, the Commission finds that the basic acreage unit to be used in the proration formula hereinafter prescribed should be 640 acres, and that in no instance shall more than 640 acres be attributable to a well for the purpose of calculating the acreage factor except: those wells having unit acreage attributed thereto lying within sections which, according to the United States Governmental Survey, contain more than 640 acres may have such excess acreage within the unit attributed thereto and except, by specific order of the Commission as hereinafter provided.

Order Dated 1-25-73

The acreage factor of a well shall equal the number of acres attributed to said well divided by 640. Expressed in a mathematical formula, said acreage factor may be set forth as follows:

$$\text{Acreage Factor} = \frac{\text{No. of acres attributed}}{640}$$

In the event that more than one well is located on any one lease, the acreage to be used in calculating the acreage factor of each well on such lease shall be determined by dividing the total number of acres by the number of wells, and the quotient thereof shall be the acreage used in making said calculation. To be considered as attributable to a well, the acreage shall be contiguous and adjoining, with the well located as near as practicable to the center thereof, and in no event nearer than 1,250 feet from any boundary line of the unit; except, however, that these restrictions shall not apply to units which have already been formed in compliance with orders issued by the Commission prior to January 1, 1960.

In the event undrilled acreage not attributed to a gas well lies within the confines of a municipality, and the drilling of gas wells thereon would create hazardous conditions and endanger the welfare of the inhabitants

of such city, the Commission may, upon proper application and after a public hearing, authorize the attribution of such undrilled acreage to a unit on which there is a producing gas well or wells, provided such well or wells are within a three-mile radius of such acreage, and further that such undrilled acreage is reasonably productive of gas; provided further that not to exceed 320 undrilled lease acres may be attributed to any one gas producing well and unit under this paragraph, making a total of 960 acres attributable to such a well.

Exceptions to the well location restriction may be granted whenever the Commission shall find that the granting of such exception is necessary to prevent waste or to protect correlative rights because of one of the following:

(1) A surface obstruction, either natural or man made;

(2) Inability to secure acreage after a reasonable attempt has been made;

(3) The well has been drilled to a depth sufficient to test the productive possibilities of the Lansing or a deeper formation, and the most favorable location for obtaining production from the Lansing or deeper formation, based on geological evidence, does not comply with the provisions of said restrictions.

Exceptions to the adjoining and contiguous acreage provision may be granted, whenever the Commission finds: (a) That the granting of such exception is necessary to prevent waste or to protect correlative rights; and (b) that a reasonable attempt has been made to form a unit made up of wholly contiguous acreage, and there is no acreage in closer proximity to the well site available on approximately the same economic basis for attribution thereto; and (c) that the average per acre reserve of the noncontiguous acreage to be attributed to a well is

reasonably comparable to the per acre reserve of the acreage upon which the well is located.

All acreage attributed to a well must be proven to be productive of gas. Provided however, that the Commission may, either on complaint filed, or upon its own motion, after notice and hearing, exclude any acreage from inclusion in any unit which, in its judgment, is not productive and should not be considered as proven acreage.

That there are located in the field certain so-called "short" sections, according to the United States Governmental Survey, and that some of such sections contain materially less than 640 acres. Whenever possible, such sections should be utilized among themselves, or with other leases or tracts, in order to form units of approximately 640 acres; Provided, however, That short sections located along the Kansas-Oklahoma state line shall be unitized only with tracts immediately north thereof and the units thus formed may contain more than 640 acres.

In cases where it is impossible to create such units, the Commission may, upon proper application, authorize the unitization of such "short" sections containing materially less than 640 acres with other tract or tracts, and under such conditions the acreage attributable to any well or wells located upon such unit may be greater than the 640 acres hereinbefore provided. However, no such unit shall receive an acreage factor attributing more than 640 acres without an express order of the Commission, and no presumption shall arise from this order that such authorization will be granted in any specific instance, and in no instance shall any unit so formed be granted more than 800 acres.

That there are located in the field certain so-called "long" sections, according to the United States Governmental Survey, and that such "long" sections lie along

the north (correction) line of Township 26 South in Hamilton, Kearny, and Finney Counties, and that such "long" sections contain materially more than 640 acres. The Commission finds that, notwithstanding anything else in this order to the contrary, the acreage permitted to be attributable to any well drilled in accordance with rules in any one of such "long" sections may exceed 640 acres but shall not exceed 900 acres, and that the acreage factor for any well located in a "long" section shall be equal to the number of acres not in excess of 900 acres, attributed to such well divided by 640. Expressed in a mathematical formula, said acreage factor for such well may be set as follows:

$$\text{Acreage Factor} = \frac{\text{No. of acres attributed}}{640}$$

In the event that more than one well is located in any of the so-called "long" sections, the acreage to be used in calculating the acreage factor of each well on such "long" section shall not exceed 640 acres. To have in excess of 640 acres considered as attributable to a well drilled on any such "long" section, only one well shall be drilled thereon in accordance with these rules, the acreage attributable shall be contiguous or adjoining and all such acreage attributable shall be located within the boundary lines of the "long" section on which the well is located. No acreage located without the boundary lines of such "long" section on which only one well is located shall be considered in figuring the acreage attributable to such well. The well, when only one well is to be drilled to any one "long" section, shall be located as near as practicable to the center thereof; in no event shall the well be located nearer than 1,250 feet from the boundary line of the "long" section.

Any well capable of producing natural gas, in existence at the time of the adoption of this order, located

in any of the subject "long" sections, shall be considered as the well for such "long" section, regardless of its location within the section, and shall be entitled to have attributed thereto, when properly unitized, acreage within said section not in excess of 900 acres.

(h) [5] It shall be lawful for the owners of two, or more, separately-owned contiguous tracts of land, or, of the minerals located thereunder, by appropriate contract between such owners to cause such lands or minerals to be consolidated as one production unit and to apportion the royalties accruing from the production of the well or wells, to be divided among them as they may agree and when such agreement shall have been made, the royalties arising from the production of the well or wells shall be allocated as the parties thereto may agree. It shall further be lawful for any operator or well owner to agree with the owners of lands or minerals to become part of a production unit and to share the royalties upon such basis as the operator and landowner or mineral owners may agree.

(i) That the producers in the field have been required, by custom, to lay gathering lines from their wells to the pipelines of the purchasers. A lease is, therefore, undeveloped until a gas-producing well has been completed thereon and the owner or operator thereof has tendered gas to a purchaser at the purchaser's pipeline. Before a well is entitled to an allowable, the owner or operator thereof should either tender the gas for sale at the prevailing price being paid in the field to a pipeline company or others who are purchasing in the field in which such a well is located, or demonstrate that he will and can produce the gas allowed such a well for lawful purposes. Such tendership may be shown by constructing a line

5. As amended by order dated January 10, 1946.

from the well to such pipe line or other purchasing facilities or by filing with the Director of the Conservation Division an affidavit setting forth that the said producer is ready, willing and able to construct said line from the well to the facilities of the purchaser, and to sell gas to the purchaser at the prevailing price in the field, but that the purchaser refuses to buy the gas when so tendered. In the event that such purchaser seeks to controvert the fact or the terms of any such tendership, such purchaser may file a protest with the Commission setting forth the facts upon which such purchaser relies in making his protest, and the Commission shall, after due notice to all interested parties, hear the protest and determine whether or not, under all of the facts and conditions existing, that such tender should not be considered has having been properly made, and whether the well shall be entitled to an allowable as a result of such tender.

(j) The adoption of a formula that will enable each well to currently produce its allowable and ultimately produce approximately the amount of gas underlying the lease upon which it is located is the object sought to be accomplished by this order. The testimony at the numerous hearings held by the Commission indicates that there are many factors which should be considered in connection with the formula, such as, acreage, pressures, open-flow, porosity and thickness of the pay. It is conceded by practically all of the witnesses that acreage is one of the most important of these factors and should be one of the factors included in the formula. It is also the opinion of many of the expert witnesses that the other factors above enumerated, namely, pressures, open-flow, porosity and thickness of pay, are all taken into consideration and given their proper weight when the deliverability of the well to put gas into a pipeline against pipeline pressure is taken into account. Therefore, a formula that considers acreage and deliver-

ability and gives due value to both should result in the establishment of well allowables that will permit each well to currently produce its allowable and to ultimately produce approximately the amount of gas which underlies the lease upon which it is located. Since the pipeline pressures in the Hugoton Field are maintained at approximately eighty percent of the average field pressure, this fact should be taken into consideration in determining the deliverability factor. Hence, the Commission finds that the formula to be used in fixing well quotas for the Hugoton Field should include the factors of acreage and deliverability. The acreage factor shall be determined as set forth in paragraph "g" of this order. Deliverability shall be deemed to be the ability of said well to produce gas against eighty percent of the average field pressure.

(k) [6] The deliverability of each connected well in the Hugoton Field shall be determined as follows: The well shall be produced into the pipeline for approximately seventy-two hours, during which time the working pressure at the wellhead shall be maintained at eighty percent of the average shut-in wellhead pressure of the field, expressed in pounds per square inch gauge and designated herein as the deliverability standard pressure, or as closely thereto as operating conditions in the field will permit. *Provided, however,* the working wellhead pressure shall, in all event, be either (1) not more than ninety percent of the shut-in well head pressure of the well being tested, or (2) equal to or less than the deliverability standard pressure, but in no event shall the working wellhead pressure be less than seventy percent of the shut-in wellhead pressure of the well being tested. If, in the judgment of the Commission's representative, it is impossible or impractical to reduce the working

6. *As amended by order dated October 3, 1945.*

pressure to ninety percent of the shut-in wellhead pressure of the well being tested, or to the deliverability standard pressure or below, the deliverability shall be calculated by substituting ninety-percent of the shut-in wellhead pressure of the well being tested or the deliverability standard pressure, whichever is greater, for Pw in the formula hereinafter set forth.

Order Dated 2-21-74

Flow shall be measured by approved meter throughout the seventy-two hour test period, and the wellhead pressure shall be measured by dead weight gauge at the close of the test period. The rate at which the well is producing at the end of seventy-two hours shall be considered the stabilized producing rate corresponding to the working wellhead pressure existing at that time, provided such rate is not greater than the average producing rate for the entire seventy-two hour period. If the working wellhead presssure at the close of the test is exactly equal to the deliverability standard pressure, then the corresponding stabilized producing rate, expressed in M.c.f. per day at a base temperature of sixty degrees Fahrenheit and a base pressure of 14.65 pounds per square inch absolute,[7] shall constitute the well's deliverability. If the wellhead pressure at the end of the test is either greater than or less than the deliverability standard pressure, the observed stabilized producing rate shall be converted to deliverability by use of the following formula:

$$D = Rx \left\{ \frac{P^2 - P^2_d}{P^2 - P^2_w} \right\} .85$$

7. *As adopted by order dated May 20, 1953. Docket No. 34,780-C (C-1825).*

where D = Deliverability.
R = Observed producing rate.
P = Shut-in pressure of the well, pounds absolute.
P_d = Deliverability standard pressure, converted to pounds absolute.
P_w = Working wellhead pressure at Rate R, pounds absolute.

The term "working wellhead pressure," as used in this paragraph, refers to pressure at the casing-head, except in cases where the casing-head is not in open communication with the producing formation because of the presence of a packer or other obstruction in the annular space between casing and tubing. In such cases, the working wellhead pressure shall be calculated by adjusting the tubing pressure for the increased effect of friction caused by flow through the tubing.

Shut-in wellhead pressure shall be measured by dead weight gauge after the well has been shut in for approximately seventy-two hours. In no case shall the well have been shut in for less than sixty-six hours nor more than seventy-eight hours at the time the shut-in pressure is taken. If the representative of the Commission should for any reason believe that the shut-in pressure taken upon a well is incorrect, he may require that such well be blown to clean fluids from the well bore, or take any such other reasonable steps that may be necessary to get a true pressure upon the well. In the event that more than one shut-in pressure is taken upon a well during the test period, the highest such shut-in pressure obtained will be used in figuring deliverability of such well.

The deliverability of each unconnected well which is recognized by the Commission as entitled to an allowable shall be estimated from its open-flow considered in connection with the average relationship between open-flow and deliverability for all wells in the field. When such well is connected to a pipe line its deliverability shall be redetermined by the method described herein.

(1) [8] To determine a well's quota for a given proration period, determine first the proration factor for the field by dividing the total field market demand for such period by the the sum of the products of deliverability times the acreage factors of all wells in the pool, then multiply the field proration factor by the product of the deliverability times acreage factor for the well. The result reached by this calculation, as hereinafter adjusted, shall constitute the well's current allowable, in cubic feet, which it may produce for such proration period, provided, that if the current allowable so determined for any well is less than 50 MCF per day, the well shall be assigned a minimum current allowable of 50 MCF times the number of days in the proration period, unless the acreage factor for such well is either more or less than one (1). In that event, the minimum allowable so assigned shall be adjusted by multiplying said minimum allowable times the acreage factor. In order that the allocation to wells within the field may be restricted to the market demand figure determined for the proration period, the proration factor as first determined, shall then be adjusted by computer computation, allowing for the additional gas necessary for allocation to minimum allowable wells.

Each operator of a well authorized a minimum allowable shall, within 90 days after this order becomes effective, file with the Conservation Division, an affidavit (on a form to be furnished by the Conservation Division upon request) stating that, in the operator's opinion, the well is capable of producing the minimum allowable; the production of the minimum allowable will not be detrimental to the well thereby causing premature abandonment; and the productive capacity of the well cannot

8. As amended by order dated September 16, 1964.

be improved by artificial means. Unless such affidavit is filed, the well shall be granted only such allowable as will be assigned by virtue of its adjusted deliverability. Wells which qualify for minimum allowables in the future shall be granted only such allowables as would be assigned by virtue of their adjusted deliverabilities until such time as the affidavits referred to above are filed with the Conservation Division.

(m) That the production of gas in accordance with the above formula has a reasonable relation to prevention of waste, to the prevention of inequitable and unfair production of gas from the common source of supply, and to the prevention of unreasonable discrimination in favor of one producer in said field and against another producer therein and that production of gas in such manner will in fact accomplish the purposes for which article 7, Chapter 55, General Statutes of Kansas for 1935, was enacted. (Kansas Statutes Annotated.)

(n) That there shall be held two market demand hearings for each year. The first hearing shall cover the period from October 1st to March 31st, both inclusive, and the second shall cover the period from April 1st to September 30th, both inclusive. The allowable period established shall be a calendar month. The Commission shall issue its orders covering each allowable period, and such orders shall be issued on, or near, the first day of the month for which such order is issued.

(o) At such time and place as the Commission shall fix, the Commission will, after notice, conduct a hearing to determine the market demand for natural gas from said field for the next six succeeding proration periods, or for such other period of time as the Commission shall prescribe, and at said hearing may determine any other questions which may properly and legally come before the Commission for consideration thereat, and a new schedule of production allowable for the wells in said

field, based upon the determination made as a result of such hearing, shall be prepared and promulgated for the ensuing proration periods.

(p) [9] Operators of wells and purchasers or others taking gas from any well, shall endeavor to limit their takes of gas to the quantities fixed in the schedule as the allowable production for such well, provided that if, during the period covered by any schedule, there should develop a substantial increase in the amount of the market demand for gas from said field, the Conservation Division may permit production to be increased ratably from all the wells in the field to meet such emergency increased demand and the facts respecting same shall be reported to the Commission at or before the next periodic market demand hearing for such action thereon as may be proper. If, at the end of any proration period, there is an overage or underage in production for any well during such period, the same shall be carried forward as a charge against or credit in favor of such well and subtracted from or added to, as the case may be, the allowable for such well for the next proration period. Any well with an adjusted deliverability in excess of 300 MCF may accumulate overproduction equivalent to six times the amount of the current allowable assigned to it for the preceding January before being shut in by the operator or producer and shall not be permitted to produce any gas until such overproduction has been reduced by deductions from such overproduction made by current allowables to the extent that the well shall not be overproduced more than five times the current allowable assigned to it for the preceding January. When any well with an adjusted deliverability in excess of 300 MCF has accumulated underproduction in excess of six

9. As amended by order dated December 27, 1963.

times the current allowable assigned to it for the preceding January, such excess shall thereupon be cancelled. Any well with an adjusted deliverability of less than 300 MCF may accumulate overproduction equivalent to nine times the amount of the current allowable assigned to it for the preceding January before being shut in by the operator or producer and shall not be permitted to produce any gas until such overproduction has been reduced by deductions from such overproduction made by current allowables to the extent that the well shall not be overproduced more than eight times the current allowable assigned to it for the preceding January. When any well with an adjusted deliverability of less than 300 MCF has accumulated underproduction in excess of nine times the current allowable assigned to it for the preceding January, such excess shall thereupon be cancelled. Any underage cancelled by the terms of this paragraph shall not be considered in determining the future production of any such well, unless, upon notice and hearing, the Commission shall otherwise determine. *Provided, however,* that in no event shall any underproduction of an unconnected well be cancelled.

"Provided also that underages cancelled under the provisions of this paragraph will be reinstated upon verified application therefore, showing that the wells are in an overproduced status; that the purchaser is willing and able to take the amounts of gas; and that the length of time proposed by applicant for the production of the amounts of gas to be reinstated is reasonable under the circumstances."

Order Dated 11-25-75

The basic allowable (preceding January current allowable) for new wells or wells retested with the approval of the Conservation Division shall be computed by using the same field allowable factor as was used for other wells in the preceding January.

(q) Deliverability tests and seventy-two hour shut-in pressures of the wells in said field should be taken by or under the supervision of a representative of the Conservation Division of the Commission, with the aid of the owner of the well. Said tests will be taken as hereinafter provided:

(1) Wells in even numbered sections shall be tested beginning on October 1 of odd numbered years and wells in odd numbered sections shall be tested beginning on October 1 of even numbered years, except as hereinbelow provided:

(2) New wells, recompleted or reworked wells shall have an initial test after such completion, recompletion or reworking and during the next three succeeding test periods. The installation of tubing in a well shall not be considered as recompletion or reworking.

(3) The Conservation Division may grant a retest on any well during the same test period as regularly scheduled for testing. However, with the installation of tubing and/or roads and pumping equipment the Conservation Division may grant a retest regardless of the year that the well is regularly scheduled for testing.

(4) Retests for a well in any test period in which it is not regularly scheduled for testing may be allowed only for good cause after notice and hearing before the Commission.

(5) [10] To avoid undue discrimination, deliverability and pressure tests on wells scheduled for testing should be taken at approximately the same time, but not later than June 1st of each year. All test data must be submitted so as to be in the office of the Conservation Division no later than June 10th of each year and all deliverability tests shall be made effective on October 1st of each year.

10. As amended by order dated September 19, 1968.

Prior to the testing of any well, reasonable notice shall be given to owners of offset wells stating the time at which such test will be commenced. A written report thereof, signed by the persons taking and witnessing the same and approved by the representative of the Conservation division who took or supervised the same, shall be made and filed with the Conservation Division, forms for which shall be furnished by that Division. The acreage of each well shall be certified in writing by the owner of the well and filed with the Conservation Division. If the acreage assigned to any well should be increased or decreased at any time after the initial report thereon is made, such fact shall be promptly certified by the owner to the Conservation Division. Any operator in the field shall have the right to challenge the correctness of the acreage assigned to any well. As new wells are brought in, their respective deliverability and acreage factors, as well as pressures, shall be taken, reported and certified in like manner.

(r) The Director of the Conservation Division shall prepare production schedules, in accordance with the provisions of this order, for the wells in said field and submit the same to the Commission for approval and upon the approval thereof, said schedules will take effect and be promulgated, and the Director shall promptly furnish to each producer and purchaser in said field a copy thereof and a copy of the order of the Commission promulgating the same and they shall govern themselves accordingly in the subsequent operation of said wells.

(s) All wells shall be equipped with meters of an approved type and the amount of gas produced from each well shall be accurately measured: *Provided,* That where more than one well is situated on a lease, a meter for each well is not required if, upon application and proper showing, the Commission finds that all the gas

produced from the wells may be accurately measured so as to determine whether production is ratable and without unreasonable discrimination.

(t) To avoid the drilling of unnecessary wells and to prevent waste, no well hereafter drilled in said common source of supply shall be assigned an allowable unless the Commission, after due notice and hearing, shall find that under all the circumstances appearing, undue or uncompensated drainage of gas is occurring beneath the tract on which such well is located or that there is an actual need for additional wells to furnish gas to fulfill the market demands for gas from said field.

(u) That this order should constitute the Basic Order for the proration of production in said field on and after March 31, 1944, and until amended, changed, or modified by further order of the Commission.

IT IS, THEREFORE, BY THE COMMISSION ORDERED: That the Basic Order heretofore entered herein dated October 24, 1942, be and the same is hereby rescinded; that this order shall constitute and is hereby designated as the Basic Order for the proration of production of gas from the Hugoton Gas Field; that the production of natural gas from said field be, and the same is hereby regulated and restricted in conformance with the findings hereinabove made and in compliance with the formula, rules, regulations and other matters therein contained.

IT IS FURTHER ORDERED: That this order shall take effect and be in force from and after the 31st day of March, 1944, and shall remain in force and effect until amended, changed or modified by the further order of the Commission.

IT IS FURTHER ORDERED: That the Commission hereby retains continuing jurisdiction of the subject matter hereof and of the parties hereto for the purpose

of issuing from time to time such further order, amendments, additional orders, rules and regulations as may be necessary and proper in the premises.

BY THE COMMISSION IT IS SO ORDERED.

VICTOR L. KIRK, *Secretary.*

(SEAL)

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners:
Richard C. (Pete) Loux, Chairman
Jane T. Roy
Phillip R. Dick

Docket No. C-164

CONSERVATION DIVISION

In the matter of establishing rules and regulations relating to the production, sale and conservation of natural gas in the Hugoton Field in Kearny, Finney, Grant, Haskell, Morton, Stevens, Seward, Stanton, Gray and Hamilton Counties, Kansas.

ORDER

Now on this 17th day of September, 1982, the above-captioned matter comes before the State Corporation Commission of the State of Kansas before Commissioners, Richard C. (Pete) Loux, Chairman; Jane T. Roy; and Phillip R. Dick.

Being duly advised in the premises the Commission makes the following findings and conclusions:

1. On March 15, 1982, this Commission issued an order in this docket instituting a general investigation into the provisions of the Basic Order for the Kansas Hugoton Gas Field. The Commission determined that hearings should be scheduled to review various provisions of the Basic Order and to receive testimony from all interested parties on the issues presented.

2. The Commission has previously held hearings reviewing the percentage used in the method of computing the deliverability standard pressure and has issued an order changing the percentage to be used.

3. In view of the increase in the amount of underage being cancelled in the Hugoton Field, the Commission

feels it is appropriate to reconsider the existing policy affecting over and under production and the reinstatement of cancelled underage. Paragraph (P) of the Basic Order sets out Commission policy with regard to overproduction and underproduction from the Kansas Hugoton Field. That section provides that any well with an adjusted deliverability in excess of 300 MCFD may accumulate overproduction or underproduction equivalent to six times the amount of the current allowable assigned to it the preceding January before being shut in due to excessive production or having the accumulated underproduction cancelled. Any well with an adjusted deliverability of less than 300 MCF may accumulate overproduction or underproduction equivalent to nine times the amount of the current allowable assigned to the well for the preceding January before being shut in or having such accumulated underproduction cancelled. Paragraph (P) further provides that underages cancelled under the provisions of this paragraph will be reinstated upon verified application showing that the wells are in an overproduced status; that the purchaser is willing and able to take the amounts of gas sought to be reinstated; and that the length of time proposed by the applicant for the production of the amounts of gas to be reinstated is reasonable under the circumstances.

4. The Commission proposes to review the existing policy under Paragraph (P) of the Basic Order with regard to overproduction and underproduction and to determine whether or not changes should be made in the existing policy.

IT IS, THEREFORE, BY THE COMMISSION ORDERED that a hearing on the question of whether changes should be made in the existing policy concerning underproduction and overproduction of gas from the Hugoton Field and the reinstatement of cancelled underage shall

be held on November 3, 1982, at the Wichita Royale, 125 N. Market, Wichita, Kansas, beginning at 9:00 a.m. The Commission has also set aside November 4th and 5th if additional time is needed for hearing.

All parties wishing to give testimony in these proceedings shall prefile testimony according to the following schedule. The Commission staff shall prefile testimony on or before October 6, 1982. All other parties shall prefile their testimony and exhibits on or before October 20, 1982. Copies of all prefiled testimony and exhibits shall be mailed by the party submitting it to all persons on the mailing list attached to this order. All testimony properly prefiled will be referred into the record at the hearing subject to objections.

Loux, Chmn.; Roy, Com.; Dick, Com.

/s/ Carol J. Larson
Carol J. Larson
Executive Secretary

PAG: ps

Docket No. C-164

IN THE MATTER – of the application of establishing rules and regulations relating to the production, sale and conservation of natural gas in the Hugoton Field in Kearny, Finney, Grant, Haskell, Morton, Stevens, Seward, Stanton, Gray and Hamilton Counties Kansas.

Transcript of testimony taken before the Kansas Corporation Commission, November 3, 1982, at Wichita, Kansas [Record Vol. 9].

* * *

EXCERPTS FROM TESTIMONY OF RON COOK

[6] *RON COOK* [Witness for Comission Staff], being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified on his oath as follows:

* * *

DIRECT EXAMINATION BY MS. GORHAM [Counsel for Commission Staff]:

* * *

[11] COMMISSIONER DICK:

* * *

Is there any objections to Mr. Cook's prefiled testimony being referred in the record at this time? It will be referred in.

(The prepared testimony of Mr. Cook, as amended, follows:)

* * *

[14] Q. Why has the Staff proposed these amendments to Paragraph (p)? A. For many years there has been a serious underage problem in the Kansas Hugoton Field and the problem is getting worse. The production from the field, the setting of Market Demand for the field and the implementation of Paragraph (p) of the Basic Order have resulted in huge volumes of underage. Consequently, there has been cancellation of large volumes of underage in the field for many years.

It is the intent of the Staff's proposed amendment to Paragraph (p) to alleviate part of the [15] underage problem that exists in the field. Continued implementation of Paragraph (p) as it currently reads under the existing production and allowable practices will further exacerbate the underage situation in the field.

Q. What is the extent of the underage problem in the Kansas Hugoto Field? A. In my opinion there is a serious underage problem in the field and it is getting worse. As of September 1, 1982, the current underage in the field was 204.5 BCF [Billion Cubic Feet] as compared to 144.5 BCF September 1, 1981. In August, 1982, there was 10.3 BCF of underage cancelled in the field. This is compared with only 1.7 BCF cancelled underage in August, 1981. According to Commission records, there has been over 508 BCF of underage cancelled from January 1, 1967 to August 1, 1982. Approximately 194 BCF of underage has been reinstated during this time period. The cancelled underage remaining to be reinstated is approximately 314 BCF. It is very unlikely that all the remaining cancelled underage will be reinstated and produced due to declining productivity and current market conditions.

* * *

[17] Q. Have you made a study as to what changes would be made on the monthly proration schedule if the Staff's proposed amendments were adopted? A. Yes.

Q. I hand you what the reporter has marked as Exhibit 2 and ask you to explain it. A. Exhibit 2 is a two-page exhibit. Page 1 is a Hugoton Field summary

sheet showing changes that would be made if the Staff's proposed amendments had been in effect [18] on the September, 1982 schedule. Page 2 is the field summary sheet for the September 1982 schedule with no changes.

Page 1 shows the minimum allowable wells designated with an "M" and the "limited" wells designated with an "L" for each purchaser and total field. Under the *adjusted deliverability* column, the sum of the deliverabilities for the minimum allowable wells are shown for each purchaser and total field. Under the *over-under* column, the "N" symbol shows the number of wells which received cancelled underage during the month of August, 1982. Under the *under cancel* column, the amount of underage cancelled by the limited wells is shown by purchaser and total field. Under the September *current allowable* column, the total allowable assigned to the minimum allowable well is shown. Under the September *net allowable* column, the total amount of allowable assigned to the limited well is shown.

Q. According to the September 1982 schedule, how many wells received cancelled underages? A. A total of 1,668 wells. This is 40.3 percent of the field.

Q. How much underage was cancelled according to the September 1982 schedule? A. 10.3 BCF was cancelled during August, 1982. This compares to only 1.7 BCF underage that was cancelled in August, 1981.

• • •

[20] Q. What happens to the current status of the field when the wells which have cancelled underage are reduced to zero? A. Page 1 of Exhibit 2 shows that the the [sic] field is currently 70.8 BCF underproduced. This compares to 204.5 BCF underproduction shown on Page 2. This is a reduction of 133.7 BCF or 65.3 percent.

Q. How much underage would be cancelled on the September 1982 schedule if the Staff's amendments

were adopted? A. A total of 144 BCF would be cancelled. This is the 133.7 BCF of underage up to the six or nine times limit on the wells receiving cancelled underage plus the 10.3 BCF in excess of the six or nine times limit.

Q. In other words nearly two thirds of the current underage shown on Page 2 of Exhibit 2 is from wells receiving cancelled underage? A. Yes.

• • •

[21] Q. In your opinion, will the staff's proposed amendments to Paragraph (p) improve the underage situation that exists in the field? A. Yes. There will be much underage that will be eliminated from the monthly proration schedule that have been carried for many years. Some of this underage would never be reinstated. If the amendments will provide an incentive for the operators to produce and the purchasers to take more gas from the underproduced wells, the underage situation will be improved in the field.

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[22] *CROSS EXAMINATION* BY MR. GREG STUCKY [Counsel for Southwest Kansas Royalty Owners Association]:

Q. Mr. Cook, could you briefly explain to the Commission how your proposal — or how staff's proposal would protect the correlative rights of the landowners and the producers in the Hugoton Field? A. Yes, if I may refer to some notes that I made in regard to that.

Correlative rights have been and are currently being violated by the uncompensated drainage that is occurring due to the unratable taking of allowables between offsetting leases. Future projection of gas production from the Hugoton Field indicate that this trend of accumulating more underage and cancelled underage will continue for a number of years.

There is a definite possibility that near the end of many of the wells [sic] productive life, there will be a tremendous amount of cancelled underage that will never be reinstated due to the physical inability of the wells to make up such underage. This will result in a greater violation of correlative rights, because under the present provisions of Paragraph P of the basic order, there is no incentive to reinstate cancelled underage in a timely manner in order to prevent [23] the large volumes of underage which will be cancelled permanently at the time the well is abandoned.

Therefore, it is the intent of the staff's proposal to provide an incentive for the producer and purchaser to run more gas in order to prevent more underage from being cancelled and to establish in a timely manner in which to begin reinstating and making up previously cancelled underage.

Q. As I understand from your — your response, you believe that in a nutshell this proposal would provide some incentive on the part of the purchaser to purchase more gas from the Hugoton Field, is that correct? A. That's correct.

Q. Why do you believe that? A. Well, because if you don't provide some incentive as — you know, if they run the risk of having that underage cancelled permanently, I believe that they would try to exercise better well management, if you will, to try to prevent those wells from receiving additional cancelled underage. And if there's a possibility that that underage will be cancelled permanently, I think they would try to make every effort to prevent that from happening.

Q. Have you read the testimony of Mr. Wilkonson in this matter? A. Yes, I have.

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[24] Q. Based on the historical development of the Hugoton Field, do you find that there is any evidence historically to support your proposition that incentives will be — there will be incentives if your proposal is adopted? [25] A. Well, I think the record shows, or the fact shows that the underage situation in the Hugoton Field is not getting any better; it's getting worse. And really under the present provisions of Paragraph P there really isn't any incentive to run the gas. There's no penalty for getting cancelled underage. With the idea that in time, and who knows what that will be, when they may be able to reinstate it at some future date.

All indications in the past and in the future indicate that there isn't going to be much gas run from the Hugoton Field — that the underage situation is going to get worse. And unless there is some incentive for the people to run the gas, then I think that this incentive is necessary to correct this problem.

Q. Un-huh. Back to Mr. Wilkonson's testimony. I believe he said that it was his belief that by virtue of the take-or-pay clause — contracts outside of the State of Kansas, the pipeline companies will prefer — will take the gas under the take-or-pay clauses and even under the threat of losing — of losing — under the threat of cancellation of the underages in the State of Kansas. Are you — Do you believe that would occur? A. Well, it's hard to say what really will occur in the [26] future. But I would hope that this would — until this is tried; until this is put in effect no one really knows what would happen in the future.

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[27] BY MR. JONES [Counsel for Mobile Oil Corporation, Northern Natural Gas Producing Company, Federal Land Banks of Wichita and Anadarko Production Company]:

Q. Mr. Cook, who really controls the underage prob-

lem, the producer or the purchaser? A. It's actually the purchaser.

Q. So, as you have outlined your plan, you wish to penalize whom for not taking the gas; the producer or the purchaser? A. Well, I think, Mr. Jones, that, you know, the producer has to communicate with the purchaser. And if they don't communicate, then the producer is certainly subject to whatever the purchasers [sic] demands are. So, I think they both have to share in the exercising of taking the gas from the Hugoton Field.

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[28] Q. What do the schedules show to the gas that [appellant] Cities Service is taking from Mobile connections? A. They have been underproducing their allowables.

Q. So really the question of underage is in the hands of the purchaser, not the producer? A. Well — yes. Mainly it's in the hands of the purchaser, but again, I think the operators have to communicate and try to instill some incentive with the purchaser to run gas from the well so that they don't get into the situation of having underage cancelled.

Q. The purchaser can always go and acquire new markets, or new supplies and reserves? A. Yes.

Q. So anybody that's losing reserve by cancellation of underage is the producer, isn't it? A. Yes.

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[29] BY MR. PAULSON [Counsel for Amoco Production Company]:

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[30] Q. Well, what you're saying is that you're hopeful that your proposal will increase the production? A. Will provide the incentive to increase the production, yes.

Q. And to the extent that your proposal does not provide that incentive and does not increase production to the extent that that lack of production is related to other factors, that simply can't be changed like poor markets? A. Uh-huh.

Q. Then you're not going to — this proposal would not alleviate the underage problem, would it not? The underage would still be there, you'd just be cancelling, is that correct? A. That's correct.

Q. So, you would be taking it off the books but it would still be incurred; it'd still be there. They would just be cancelled quicker. A. They would be cancelled permanently. They would not have the opportunity to go back and reinstate that unless good cause is shown why it shouldn't be cancelled permanently.

[31] Q. Now, that leads me to this question. Isn't the basic purpose of this proposal to increase production from the Hugoton Field? A. Yes, it is.

Q. And in doing or in attempting to accomplish that purpose you're saying, are you not, that it's permissible for allowables to be cancelled to those operators in the field who for whatever reason are unable to purchase — I'm sorry — unable to take the gas from their wells? It's permissible in order to accomplish the Commission's purpose to simply transfer those allowables to those operators in the field who do have markets or whose purchasers have markets that permit them to take the gas that's available? Is that the Corporation Commission's position by this proposal? A. Well you mentioned transfers of allowables and I'm not sure I understand what you mean by that.

Q. Let me go into that. I want you to assume for a minute that your proposal will not provide a sufficient incentive to increase takes by purchasers in the field. A. Okay.

Q. That perhaps the problems are related to something deeper than that can be addressed by this; just in sufficient [sic] markets to allow the gas to be taken. It's [32] true, isn't it, that under your proposal those persons who have those operators in the field who have purchasers who simply cannot increase takes in a sufficient amount to prevent massive cancellations of underage as you're proposing, those allowables would be lost, would they not? A. Yes.

Q. Incentive notwithstanding they'd be lost forever. And that gas — Gas does tend to migrate from a relatively high pressure area to a lower pressure area. So those wells that are on production are going to eventually get that gas, aren't they, that isn't being produced from the well? A. Yes.

Q. So, again, my question is this; is the Corporation Commission — is it their position that the transfer of those allowables by cancellation from those unable to take to those able to take — that that's permissible and advisable, and that it would be your recommendation that that took place in order to increase production from the Hugoton Field?

MR. BYRD: I'm going to object to that question. I don't think that that staff proposal recommends a transfer of any allowables at all.

MR. PAULSON: Well, if I might respond.

COMMISSIONER DICK: I think it would be proper [33] to restate your question. You referred to the Commission rather than Commission's staff, and I think that could be clarified if you would like to restate your question.

Q. (Mr. Paulson continuing) When I refer to transfer of allowables, I hope you mean — that I'm talking about the context of this question, I'm asking you to assume that this proposal, the staff proposal, would not provide sufficient incentive to — for whatever reason, wouldn't

allow the certain purchasers in the field to take sufficient gas to prevent a massive cancellation of underage as is envisioned by the staff proposal. So when I talk about transfer of allowables, that's what I'm talking about. In other words, if it isn't produced here, and that allowable is cancelled, then as to that portion of gas — appeared as to that operator operating that well — it's gone? His opportunity to produce that gas is gone? A. You're inferring from your question that the underage — allowables that are cancelled permanently are going to be respread to the other wells, and that's not the case. No. That's not what the staff's proposal is at all. It will not be respread to the other wells.

Q. Well, I appreciate that's not your proposal, but tell me [34] why that wouldn't take place. A. Because, simply, the deliverability formula will still be in tact [sic], the allowables will still be assigned on the basis of the well percent participation in the field. That would not change at all. And the fact that that underage is cancelled permanently under — well, doesn't mean that that's going to be produced somewhere else as an allowable. It may be produced as a result of migration of gas from the high pressure areas to the low pressure areas, but certainly is not transferring allowables or respreading the allowables at all. I don't see it that way.

Q. Well, okay. Let me ask you this; I want you to assume again for the purpose of this question that as to certain operators in the field that there is a possibility that those operators [sic] purchasers [sic] markets might improve two-and-a-half years or three years or four years down the line, and that were it not for the adoption of this proposal, your staff proposal, that those operators might then have had the opportunity to produce that gas by reinstating the cancelled underage. Now your proposal would eliminate that possibility, would it not? A. Well, they do have a time frame in which to get their

wells in shape to do this. I think it's purely speculation to suspect what may happen two years, [35] two-and half, or three years down the road. So I really — First of all I have trouble buying your assumption that this may not work. I think until it's tried you really don't know. But I certainly would — This is certainly not transferring allowables, it's not respreading the allowables, it's simply providing a time frame in which to try to get these wells in shape so that they can make up these underages within a reasonable time period.

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[37] Q. And my question to you is; is the Commission's staff — staff's proposal — does it envision taking that risk or of using correlative rights to that extent to try to produce a desired objective? A. Well, the whole purpose of this — of this proposal is the fact that the correlative rights are being violated now, and has been in the past; and is currently going on and will continue on in the future. There's a violation of correlative rights going on now. Until something is done, and certainly no incentive under the present provisions of Paragraph P to do so. So unless there is something — some incentive instead, then this situation is just going to continue on and may never be resolved.

Q. Well, you're saying that the rights are being abused at the present time by the underage problem? A. Right, there is violation of correlative rights going on now.

Q. And that you want to alleviate the underage problem by this proposal? A. Yes.

Q. Would it be possible to alleviate the underage problem by, for instance, shutting in overproduced wells and cutting nominations, wouldn't it? A. Yes.

Q. And that would alleviate the underage problem?

[38] A. That would probably help. That wouldn't be the only solution.

Q. But that — A. I mean that's possible, yes.

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[41] BY MR. McCARTHY [Counsel for Northern Natural Gas Company]:

Q. Mr. Cook, you're appearing here as a Commission's staff witness and I would like to have you state what your understanding is of the responsibility of the Commission regarding the conservation of gas in the Kansas Hugoton Field. A. That's to protect correlative rights and prevent waste.

Q. All right. Zeroing in on correlative rights, how does the Commission protect correlative rights in the Kansas Hugoton Field? A. .By assigning allowables such that each operator will have the opportunity to recover his proportionate fair share of the recoverable reserves underlying their lease.

Q. And to accomplish that, the Commission has adopted the deliverability formula in the basic order, is that not correct? [42] A. That's correct.

Q. And the way that formula works, as I understand it, and you correct me if I'm wrong. The objective is to bring down the pressures — the shut-in pressures of the well in the field uniformly? A. That's correct.

Q. Is that correct? A. That's correct.

Q. And, I believe it's your testimony here this morning that since correlative rights are being violated presently, as you say, obviously those pressures are not being brought down uniformly? A. No, they aren't.

Q. Is that correct? A. That's correct.

Q. And to the extent that the Commission grants allowables which are produced by some wells and not produced by other wells, to the extent that this continues to occur in the future, I assume that correlative

rights will continue to be violated, is that correct? A. That's correct.

Q. And, is it a reasonable conclusion that if the Commission assigns allowables to wells in the field in excess of the market demands of the purchasers, that those wells will likely not produce their allowable, is that correct? [43] A. That's correct.

Q. So that if the present situation continues, you can foresee, can you not, that the adjusted deliverabilities of the wells in the — in the field, Kansas Hugoton Field, will continue to have a wider and wider disparity, is that a reasonable conclusion? A. Yes.

Q. Now, referring to your proposed solution to this problem, and fixing in mind that the objective is to bring down the wells — the shut-in pressure on the wells uniformly, would you tell us how your proposal accomplishes that? A. Well, the only way that you can accomplish bringing the pressures down uniformly is a timely production of the allowables. And there has to be some incentive to run those allowables. And if the fact that those underages may be cancelled permanently may instill the incentive for the purchasers and the producers to run more gas out of the field so that this will not happen — So it is the only way that you're going to accomplish bringing the pressures down uniformly as has been historically in the field in past years — is the timely production of those allowables. So you have to provide some incentive to produce those allowables.

Q. Your testimony is, and I certainly agree, that in order to bring down the pressures of those wells uniformly [44] requires production as opposed to anything else. You do it by production. A. That's right.

Q. And your testimony is that the Commission should provide some incentive to facilitate that production. A. Yes.

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[45] Q. Turning again to your proposal for amending Paragraph P, is it your testimony that that will in fact increase the field production? A. I would hope that it would provide the incentive to increase production, yes.

Q. Does your proposal itself have an effect on the shut-in pressures of the wells? A. Certainly, if they start running more gas from the field to prevent or make-up, it should lower the pressures of those wells.

MR. McCARTHY: Would you reread the question please.

(The preceding question was read back by the court reporter.)

A. Yes, it would.

Q. Tell me how. [46] A. By producing the gas — lower the pressures in the wells. And to the point that the higher pressured wells should come down more in line with what the other wells pressures in the field would be.

Q. I don't want to quibble with you, Mr. Cook, but does your proposal increase the production of gas in the field? A. If it provides that incentive to run the gas, it will.

Q. If it does? A. If it does, yes.

Q. Now, I believe, on Page 3 of your testimony, in Question 9 [page JA-32, *supra*], in the answer to that question, you state that the setting of the market demand in excess of the purchasers [sic] requirements is one of the factors for the resulting huge underage in the field, is that correct? A. Yes.

Q. Would you say that's a primary reason for that underage? A. I wouldn't necessarily say it was a primary reason, but it's certainly one of the reasons.

Q. How long has this underage been accruing? A. The 204 1/2 billion that's shown as current underage

has been accruing since January 1, 1967. And also the amount of underage that's being cancelled has been accruing since that — January 1, 1967.

Q. And you believe that it's fair and equitable that this underage should be produced within the next two years? [47] A. Yes, I feel that if that's delayed any further that it's going to result in — in a more — greater violation of correlative rights, if it's something that's not done soon. And I think two years is certainly reasonable time.

Q. And does that two-year recommendation of yours take into account the markets of the respective purchasers? A. Yes.

Q. You're saying that those two markets can absorb this underage within the next two years? A. I think that the — with a more concentrated effort on the parts of the purchasers and the producers together, I think this can be accomplished.

Q. What form would this concentrated effort take? A. Certainly would take a cooperative effort on everyone's part to do so.

Q. Mr. Cook, you were formerly with the pipeline company. You know that pipeline companies have limted [sic] markets, whatever those markets are. You know that many of them purchase from many different sources in many different States. Do you think the problem is unique in Kansas, or how do you accommodate the — the situation in the various States? If the producers and purchasers have to work together in Kansas, that means they almost have to work together in other States also, does it not? [48] A. Yes, I would hope so.

Q. And can they provide a higher market or what — I don't understand where you're going to find the markets for all of this underage. It's very simple. A. Well, there may have to be — and I don't — this is purely speculation on my part. I think there may have to be

— maybe revaluation [sic] of where — where most of this gas is being — to provide the present markets is being taken from. There may have to be some better control as to how much gas is taken from each of these sources of supply.

Q. Do you suggest that the Kansas Commission ought to have that control or do you suggest the Oklahoma Commission or the Texas Commission or perhaps the BLM in the offshore area: who should have that control. A. The control of taking the gas?

Q. Requiring the gas to be run. A. Well, I feel that the Commission should provide — well, certainly the markets that the pipeline companies are going to — but it's the gas that they are taking from their other sources of supply. We don't know or at least I don't think the Commission knows in what percentage gas is being taken from, say, the take-or-pay source of supply versus other sources of supply. Certainly there is a possibility that maybe Hugoton Field is being, let's say, maybe more [49] discriminated against more than other fields as far as taking gas from the field. And so, until this is known and until evidence is shown that Hugoton Field — that the situation in the Hugoton Field is no different than anywhere else, then I think that all indications are that with a tremendous cutback in the Hugoton Field over the past — within the last year or two that the Commission has provided [sic] some incentive to run the gas from the field.

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[52] BY MR. BYRD [Counsel for Mesa Petroleum Company]:

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[53] Q. Now, in answer to a question that Mr. Jones asked you, did you mean to imply that the reserves are lost by the cancellation of underage? A. No.

Q. Now, several times in your — or several Counsel have asked you regarding whether or not you think this incentive that you propose will work. Has this incentive been used in other fields, other proration orders to your knowledge? A. No, but I know in the other fields there's been a tighter flexibility of over and underproducing the [54] allowables.

Q. And, have you ever had occasion to observe whether or not people try to stay within those tighter field rules in the other areas? A. Yes, I believe, generally speaking, they did try to stay within those tolerances.

Q. As I understand your answers to some of the questions and your summary of your testimony, you feel that this is particularly important in this field, as we might be reaching the latter stages of completion, is that right? A. That's right.

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[56] BY MR. BROCK [Counsel for Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum, Inc.]:

Q. Mr. Cook, I believe you stated several times that correlative rights are being violated in the Hugoton Field at this time, is that correct? A. That's correct.

Q. And that is due to the underproduced status and the underage incurred on quite a number of wells, is that correct? A. That's correct.

Q. And I take it, the drainage and the violation of the correlative rights then is from the underproduced wells over to the areas of the wells where they are running their allowables, is that correct? A. That's correct.

Q. And is that due to the fact that when wells accumulate underage and cancelled underage that their pressures are higher than the wells — than the pressure of the wells which are running their allowables, is that right? A. That's right.

Q. Now, so you have a drainage situation? A. Yes.

Q. Now, is it not correct that the only way you can get compensating drainage then, is for those wells with that underage to produce their current allowables and their [57] underage so they can get their pressures below the wells which are running their allowables to get some counter drainage back, is that correct? A. That's correct.

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[58] Q. So then, without — without being able to reinstate the underage, you have been denied the opportunity to reinstate it and produce it? A. Well, they've had the opportunity to produce those allowables in the past. If there is some incentive provided to where they can make up those underages, then they still have that opportunity. They have two years in which to reinstate it and then two more years [59] in which to produce it. So they're not denied that opportunity to do.

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[67] Q. Now your proposal is really based primarily on incentive, is it not, to try to get the pipeline companies to run the gas which is now accumulating as underage, is that not true? A. That's true.

Q. Do you have any definite facts that your proposal would actually cause this? A. I don't have any facts, no.

Q. So that really is somewhat speculation? [68] A. I think any proposal can be considered as speculative.

Q. All right. If a pipeline company — let's use [appellant] Cities Service as an example. I believe they have testified in market demand hearings about their lack of market and their decreasing market, have they not? A. Yes, they have.

Q. Using them as an example, how can [appellant] Cities Service run the gas from these wells if they have no market or place to go with it? A. Well, I'd say they have a problem.

Q. There also is a certain gas surplus in the mid-continent area at this time. Is there not? A. I understand there is, yes.

Q. Some operators anymore even having difficulty in Oklahoma and some areas of getting their wells hooked up, is that not correct? A. That's correct.

Q. So that even if the pipeline company did suffer some cancellation of connected reserves, they still would have opportunities to make it up in other areas, is that not correct? A. Yes.

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[69] BY MR. GLAVES [Counsel for Panhandle Eastern Pipe Line Company]:

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[70] Q. Now the — I notice that the order setting this matter for hearing indicated that the problem being addressed — the [71] concern is that the existence of the underage; that an increasing amount of underage is being cancelled. Do I gather from your testimony and the questions of other Counsel that the conclusion is that most of that is being — that the reason that that is occurring is because of market conditions? A. One of the reasons, yes.

Q. And, of course, then [sic] market has been changed legislatively too by the National Congress, hasn't it, because of the Fuel Use Act and incremental pricing and other devices that diverted use of natural gas from industrial markets? A. It certainly has had a bearing on it, yes.

Q. And, of course, this Commission cannot create a market, can it? A. No, it cannot.

Q. But what you simply are doing is trying to provide some incentive that the purchasers will take this underage, given the limited market? A. That's correct.

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[78] BY MR. MARTIN [Counsel for Kansas-Nebraska Natural Gas Company]:

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[83] Q. You've studied, I presume, the present proration rule. A. Yes.

Q. Are you acquainted with the — with the language that appears in the Field Order booklet, at the bottom of Page 17, the top of Page 18, last — starting with the last paragraph [page JA-24, *supra*]. I'll read it to you. I think you [84] will recognize it. "Provided also that underages cancelled under the provisions of this Paragraph will be reinstated upon verified application therefore, showing that the wells are in an overproduced status, that the purchaser is willing and able to take the amounts of gas, and that the length of time proposed by the applicant for the production of the amounts of gas to be reinstated is reasonable under the circumstances." A. Yes, I've read that.

Q. Do you have some objection to that language? As part of — A. Yes, as part of my proposal I'm recommending that that be changed. That the change being that at the end of that time perio the wells underproduced, the underage that has not been made up will be cancelled permanently.

Q. But you're also saying that if you have cancelled underages, and at the end of the given time period the well is — just as this language I read you said. There can be a showing made that the wells are in an overproduced status and that the purchaser is willing and able to continue to make up, that he should be given another year to do it. A. Yes.

Q. Well, as a practical matter, what is the difference in [85] the application of your rule and what we're dealing with here? That's what's being done now. A. No,

that's not being done. What's being done now is, at the end of the time period, the underage which has not been made up and the well is in an overproduced status, then that underage is simply removed. No, under the current rules — under the current provisions of Paragraph P, it's simply removed from the schedule. At a later time, when the operator gets his well in an overproduced status, he can come back in and reinstate that which he did not make up previously.

Q. Uh-huh. A. And under the staff's proposal, at the end of that time period, if the wells in an underproduced status, the underage is cancelled permanently. That's the difference.

Q. So there does come a time when you end up permanently cancelling a part of the underproduced gas from a well. A. When the well is in ah underproduced position, yes.

Q. When that cancellation takes place, can this result in drainage from that leaseholder's — or that unit to surrounding units of at least that part, or a significant part of the gas for which the cancellation was imposed? A. I'm not sure I understand your question. Are you saying if the underage is made up, that that's going to [86] result in drainage?

Q. No, I'm asking you the opposite of that. If a cancellation took place — if there's accrued underage and the gas is under the ground and that section of land could be produced, but if there's a cancellation, does the fact that that underage is cancelled and that well doesn't have the right to produce it, can that result in drainage in favor of adjoining property? I'm not asking you if it will in every case, but I'm asking you if it can. A. By not producing, it will it result in drainage?

Q. Yes. It's there. In fact it's in place in the reservoir — could be produced, but it has been cancelled, so it can't be produced from that well. Now, does that create the possibility that there will be movement of gas away from that lease or that unit onto adjoining — or other units in the field? A. Well, of course, this is what's occurring now.

Q. Well, that's not what I asked you. A. Yes, if you don't produce it, yes, subject to being drained.

Q. Well, the answer to my question then is if there's a cancellation imposed, the gas is in fact in place under there and could have been produced absent the cancellation, that can create drainage away from the property, right? A. Yes.

[87] Q. Have you made any study to determine the effects of that drainage? A. No, I haven't.

Q. Well, specifically, have you formed any opinion or made any study as to what the effects of drainage might result from cancellation under your proposal might be on, for example, Kansas-Nebraska who is currently making up its underages? A. I haven't made that study.

Q. You haven't approached that question at all? A. No.

Q. You do recognize, do you not, that under the — under the entire regulatory scheme, one of the Commission's obligations is to protect the correlative rights? A. Yes.

Q. That might effect [sic] correlative rights, what I put to you. A. Yes.

Q. But you haven't looked into it? A. Well, I know that there is correlative rights being violated currently and in the past. If some incentive isn't done and gas isn't produced in a timely manner, that there will be a great violation of correlative rights.

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[88] BY MR. PAULSON [Counsel for Amoco Production Company]:

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[90] Q. Well, whose underage is being cancelled? Whose allowable? The producer or the operator? A. Well, I thought producer and operator were the same.

[91] Q. I'm sorry. The operator or the purchaser. A. It would be the operator.

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[94] *RECROSS-EXAMINATION* BY MR. McCARTHY [Counsel for Northern Natural Gas Company]:

Q. I'm interested, Mr. Cook, in how we should readjust our purchases of gas to accommodate greater takes out of the Hugoton Field. Would you illustrate on that? A. Well, my thinking there was the fact that possibly there could be some reajustment [sic] in maybe the takes from other sources of supply, maybe less gas taken from the take-or-pay sources, for example. Maybe instead of taking the maximum from take-or-pay, maybe take the minimum from take-or-pay. Then make up that difference from the, say, Hugoton Field. That's what I meant by the change in the mix.

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[96] BY MR. BROCK [Counsel for Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum, Inc.]:

Q. On this matter of readjusting their takes from various sources of supply so that they could — within their market — so that they could take more from the Hugoton. If it was a choice between paying for gas not taken from other sources versus having underage cancelled here in the Hugoton, it could be a very expensive process for a purchaser to do that, is that not correct? A. Could be, yes.

Q. For example, I believe, what, the Hugoton is hav-

ing about 11, 12 billion cubic feet cancelled each month now? A. Yes.

Q. And that would be extremely expensive for purchasers to take that much gas from other sources without — I mean [97] to pay for it without taking it, is that not correct? A. That's possible, yes.

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EXCERPTS FROM TESTIMONY OF WILLIAM E. FEEMSTER

[100] *WILLIAM E. FEEMSTER* [Witness for Amoco Production Company], being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified on his oath as follows:

DIRECT EXAMINATION BY MR. PAULSON [Counsel for Amoco Production Company]:

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[103] COMMISSIONER DICK: Is there any objections to Exhibit No. 3? It will be admitted.

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Is there any objection to his testimony being referred into the record? It will be referred in.

(The prepared testimony of Mr. William E. Feemster, follows:

* * *

[104] Q. What is Amoco's position in the Hugoton Field? A. Amoco presently has 787 producing gas wells in the Hugoton Field. Of those, 764 or 97% are hooked up to [appellant] Cities Service lines. The remaining wells are divided between Northern Natural, Kansas-Nebraska and Colorado Interstate. As of August 1, 1982, only 6 of [105] those 764 wells are in an over-produced status.

Q. What about underproduced wells and cancelled underage? A. If you look at Exhibit 1 [Official Exhibit 3] attached, in the second part, you'll see that Amoco's Hugoton wells have had 73,771,905 Mcf [Thousand cubic feet] of gas allowables cancelled by the Kansas Corporation Commission, which is presently available for reinstatement when the wells qualify for such reinstatement. This cancelled underage is from 525 wells which were underproduced in sufficient quantity to be cancelled.

The remaining 233 wells are underproduced but haven't yet suffered cancellation.

Q. What, in your opinion, is the reason for Amoco's underproduction and for the 73.7 BCF of presently cancelled underage? A. The allowables which are being assigned by this Commission to our wells exceed our purchasers' demand during soft market periods such as now exists.

Q. So the problem is two-fold. A. Yes, (1) Almost all of our gas is dedicated to [appellant] Cities Service whose market demand is currently down in proportion to other purchasers, as reflected by Mr. Cook's exhibit. (2) The Commission is assigning allowables in excess of our purchaser's demand.

Q. Has Amoco been in a comparable situation as to cancelled underage in the Hugoton before? [106] A. Yes, please look at our Exhibit 1 [Official Exhibit 3], in the first part. During the late 1960's and early 1970's we were in a situation similar to our present one. However, during the period from May, 1972 through 1981 a total of 66,707,113 Mcf cancelled underage was reinstated. A total of 60,650,544 Mcf of the reinstated underage has been produced, representing reserves that would have been lost if the cancelled underage had not been re-instated by the KCC. The remaining 6,056,569 Mcf is still being recovered pursuant to Orders issued by this Commission and all of it may be recovered depending upon the market demand for our purchasers' gas.

Q. How will the Commission's suggested changes in the Basic Proration Order affect Amoco and other underproduced producers in the Hugoton Field? A. Under existing rules allowing over- and underproduction of allowables which are prorated on the basis of individual interests in the field reserves, compensating migration of the gas in place is permitted. During soft market periods Amoco suffers temporary drainage which

is reversed when our purchasers' demand increases. At the present time Amoco's purchasers have a soft market, and therefore Amoco is on the underproduced side with 781 of our 787 wells in an underproduced [107] status. Of these 781 underproduced wells, 525 have suffered cancelled underage of 73,771,905 Mcf, of which 1,331,700 Mcf is attributable from minimum wells, with the remaining 72,440,205 Mcf being producible when market demand increases. These volumes are increasing monthly with current assigned allowables exceeding our purchasers' demand. In the absence of an immediate turnaround in our market, these reserves will be lost to us and our royalty owners under the suggested rule change.

Q. Have you reviewed the testimony of Ron Cook, the consulting engineer retained by the Commission, which has been prefiled in this matter? A. Yes.

Q. How will those proposed changes affect Amoco's ability to make up the cancelled underage? A. The suggested change requires 2 months qualification and makeup within 2 years. In view of the current and anticipated market demand, Amoco will not be in a position to obtain re-instatement of the cancelled underage and sell it during the next two years and thus Amoco and its royalty owner reserves will be lost, and will be produced by other producers in the Hugoton Field who happen to have purchasers with better markets.

Q. What effect will these changes have on correlative rights in the Hugoton Field? A. The reserves which have currently migrated toward other wells will [108] be lost unless we are permitted to recoup them in the future. The correlative rights of Amoco, our royalty owners and other similarly situated producers and royalty owners will not be protected if the proposed changes regarding reinstatement of cancelled underage are adopted.

* * *

Q. What then, is your recommendation? A. That this Commission retain the same rules that were in effect while Amoco, suffering under allowables exceeding market demand, incurred its cancellation of underage; and that such rules be retained until the purchaser's markets improve and we, and others similarly situated, can recoup our losses.

* * *

AMOCO PRODUCTION COMPANY
HUGOTON GAS FIELD
CONNECTIONS TO CITIES SERVICE

PREVIOUS REINSTATED
CANCELLED UNDERAGE

Total Reinstated	66,707,113 MCF
Produced To Date	60,650,544 MCF
Percentage Produced	90.9%

ADDITIONAL CANCELLED UNDERAGE
AVAILABLE FOR REINSTATEMENT

Underage Available	73,771,905 MCF
Amount From Minimum Wells	1,331,700 MCF
Produceable Underage	72,440,205 MCF

Exhibit 3
Admitted
November 3, 1982

[109] *CROSS-EXAMINATION* BY MR. DALE STUCKY [Counsel for Southwest Kansas Royalty Owners Association]:

• • •

[113] Q. Would you explain to me a little bit about the manner in which Amoco supplies [appellant] Cities Service demand for gas from Amoco's wells in Wyoming?

• • •

A. I'm not clear on the question.

Q. Would you explain to me or tell me how it happens that Amoco supplies a demand for gas, [appellant] Cities Service demand for gas by delivery of gas from Amoco to [appellant] Cities in Wyoming? A. We developed a field in Wyoming. I know this.

Q. Well, what field was it? A. The Moxa Wamsutter, M-o-x-a W-a-m-s-u-t-t-e-r, I think.

Q. When was that field? A. This field was developed before I arrived in Denver. I have to plead that I do not know exactly when. It's what we term recent. Say the last five years would [114] be an estimate.

Q. Five years. And would you tell us about that — how that supply was developed and how it's handled? A. I'm not familiar with all of the facts involved.

Q. Well, I understand that. A. I do know they sell to [appellant] Cities.

Q. I don't suppose any one man would be familiar with all of the facts. Would you please just tell us what you know? A. Okay. I'm involved in monitoring our purchasers [sic] contracts. I don't pay that much attention to when they begin. It's current conditions that I review. My familiarity with that field and the production from it is limited to that. I cannot even tell you exactly what that field is producing. I can tell you that our production is down. It has been cut considerably since I arrived in Denver which was over 12 months ago. That's

about the limit of it. I have not evaluated whether or not they're taking their obligations or not. But I do know, just from observing monthly production decline that the production is down, a lot.

Q. When you are talking about whether they're taking their obligations, what do you mean by that? A. Their obligations in that field is a function of its deliverability. I cannot tell you what the deliverability [115] is, either.

Q. But, what is the obligation? You said it's a function of deliverability. Now, what is the obligation? A. I think it's 80 percent of deliverability.

Q. Is that a take-or-pay situation? A. Yes.

• • •

[125] BY MR. McCARTHY [Counsel for Northern Natural Gas Company]:

Q. Mr. Feemster, on Page 2 of your testimony, in response to Question No. 9 [page JA-57, *supra*], you indicate that, "The allowables which are being assigned by this Commission to our wells exceed our purchasers' demand". Do you see that? A. Yes.

Q. Do you know whether the total field allowables being assigned by the Commission exceed the total purchasers' demand from the field? A. At the last market demand hearing -- again, I would like to round off numbers. At the last market demand hearing I witnessed the purchasers nominating, I believe, it was 128 Bcf. [Appellant] Cities Service percentage of that nomination was about 20 percent.

Q. May I interrupt you right there. A. Where is — wait a minute, let me finish this. And the allowables that they would receive from that 128 nomination was about 40 percent of it. So, Amoco was immediately, if the Commission had accepted those [126] purchasers [sic] nomination, our allowables at that time would have been

twice what [appellant] Cities said they was [sic] going to take from our wells. The Commission then set an allowable based on a nomination of 175,000 Mmcf, as I read in their order. They increased it something like 30 — something plus percent of the total nominations. So, Amoco's situation for the six months, anticipated situation, would be — 20 into 40 is two, and another 30 percent. Our allowables are approximately 2.7 times what [appellant] Cities said they was [sic] going to take from our wells for those six months.

* * *

[127] BY MR. CARY [Counsel for Appellant]:

Q. Mr. Feemster, looking at, I guess, Page 3 of your testimony, be on Answer 11 [page JA-57, *supra*]. You talk about for the period from May, '72 through '81, a total of about 66.7 Bcf of cancelled underage was reinstated. Mr. Feemster, do you have an opinion as to — I'm going to give you a hypothetical. If Mr. Cook's proposal, as he has proposed today, had been in effect back in '67, I would say, to early '70's when this field was greatly underproduced, would Amoco have had underage permanently cancelled which it ultimately was able to make up? [128] A. I believe that we would have lost all or at least some of that underage that was reinstated that we were able to produce. It would depend, of course, on whether or [sic] we could have qualified a well in the two months and recouped some of it during that two-year period, so forth, so forth. But, that number that you're quoting from, Exhibit 3, does represent the potential loss we could have suffered under this existing — where this recommended rule changed.

Q. And you were able to make up, as your Exhibit 3 shows, approximately — well, 60.6 Bcf? A. Yes.

MR. CARY: Okay, no more questions.

THE WITNESS: I might add this took us a period

of eight to ten years to do it though.

Q. (Mr. Cary continuing) Correct, but this field has a long life ahead of it anyway, I assume. A. Yes, sir.

Q. So that it's possible for this — very possible for this field to continue to produce much in excess of eight to ten more years? A. Yes, sir.

Q. In light of this, is it also your opinion that again, say, if I could give you a hypothetical, four or five years down the road, if purchasers [sic] markets pick up, that [129] a fair amount of the cancelled underage could also be made up if the Commission's rules were to remain the same? A. If the Commission's rules remain the same, I feel that a considerable — well, we recovered 90 percent of the cancelled underage you referred to over those eight or ten years I mentioned. It would not be unreasonable to estimate that 90 percent of this 30 — or 74 Bcf could also been [sic] recouped. But our problem is continuing to worsen in that we are — in addition to this 74 Bcf on this exhibit, we're getting underage cancelled monthly. This volume is increasing each month.

* * *

BY MR. BYRD [Counsel for Mesa Petroleum Company]:

* * *

Q. I was interested in an answer you gave to a question where you said that had the Commission fixed the market demand at nominations, you wouldn't be hurt as bad as you were on these 175 [Bcf]. Is Amoco interested in producing more gas out of Hugoton? A. Yes, sir.

[130] Q. You're only producing five days a month now? A. Yes, sir. And I'm getting all kinds of heat as to why.

Q. Now, do you think lowering the allowable — normally lowering the allowable would increase the wells [sic] production? A. Lowering the allowable at this point wouldn't change our production. We have enough underage to ride this for six months to a year.

Q. But, you don't believe, do you, that your production should always just be dependent upon what your purchaser decides in a particular month or year to run from your well? A. No.

Q. Well, isn't that what you indicated by your testimony that you want them to — A. Well, you asked me if I thought that was right, and we put in as many contracts as we can obligations for them to take so that we have leverage to force them to take more gas.

Q. That's why you have the 80 percent take-or-pay in Wyoming, isn't it? A. Yes, sir.

• • •

[133] Q. (Mr. Byrd continuing) Mr. Feemster, Mr. Stucky asked you about your meaning of market demand. Are you referring to the nominations that your purchasers submit, is that your definition of market demand? A. My common defintion [sic] of market demand is what the purchaser will take. Now, nominations are an indication of what he says he is going to take. The real demand is what he tells Amoco he will take from our wells.

Q. Well, does he tell you something different than he tells the Commission in his nominations? A. They're not always the same.

Q. Are they usually higher or lower? A. Both.

Q. Do you know how he makes up his mind as to how much he tells you he's going to take? A. No. Depends on how hard I'm screaming. I imagine he tells me that he's going to to [sic] take more than he actually can.

• • •

[136] Q. Now, you state in answer to Question No. 11 [page JA-57, *supra*] that the reserves that you are talking about there, the previously cancelled and reinstated underage would have been lost if cancelled underage had not been reinstated by the Commission, is that — You are a petroleum engineer, are you not? A. Yes, sir.

Q. Are you saying to this Commission that if those allowables had not been reinstated, that the reserves in that amount would have been lost? A. Yes.

Q. Explain to me how that happens. What causes it? A. These reserves represent the share of Amoco's — I mean the share of the field reserves attributable to Amoco.

Q. What is that percent, do you know? A. That percent is — is the allocation factor to each well.

[137] Q. Do you know what percent of the reserves Amoco has in the field? A. Reserves? No. I'm not discussing total reserves and another total to subtract to arrive at losses. I'm seeing these as losses.

Q. You're equating allowables to reserves? A. Yes, sir. The allocation formula does that.

Q. I see. What happens to a well — Amoco's wells when it's underproduced? A. The gas is — The gas moves from the underproduced well towards normal or overproducing wells.

Q. What happens to the allowable? A. The allowable? The future allowable of the well, if the pressure is not drawn down as much as those normal and overproduced wells, the future allowable increases slightly.

Q. Have you made a study to study the relationship between the increase in allowable because of the higher pressure on your underproduced wells and the amount of gas that migrates off your lease? A. No.

Q. Then you don't know whether or not those reserves would have been lost, do you? A. I know that part of them will be lost.

Q. All right. Mr. Feemster, when you start producing — when you produce that underproduction that was reinstated, [138] what happened to the pressure of your wells? A. Then the reserves occurred. While we were producing the allowable and the additional underage that had been cancelled as additional allowable, then our pressures reacted like the pressures in the wells when we were losing our production.

Q. Did you get some wells in a shut-in position? A. We had some wells that we were paying close attention to. They were approaching that maximum overproduction.

Q. So, if the formula's working correctly — if your well was approaching shut-in, you evidently had more than made up your fair share of the reserves, hadn't you? A. Yes, sir. At that point.

Q. Do you suppose that results from the fact that some of the allowables that were cancelled and reinstated were excessive because of the higher pressure on the well? A. Some, but as you produced it, you brought — you brought that pressure right back down.

Q. But, you brought it down below the average pressure in the field? A. In some cases.

Q. So that — The reservoir's telling you at that stage that you produced more than your're [sic] entitled to, isn't that right? A. I'm not going to say that.

Q. I see. You're an engineer, but you don't believe that's [139] right? The formula's working right, wouldn't that be true? A. I couldn't confirm that with my knowledge.

* * *

Q. Is there any way that you know of that Amoco can protect itself from temporary migration of gas from

its leases other than having the gas produced? A. Yes.

[140] Q. How could that happen? A. Cut back on the production of the wells that are pulling the gas from our leases.

Q. All right. If the — Well, ultimately you're going to have to produce the gas, aren't you? A. Yes.

Q. So if restriction of production of the other wells in the field caused their well pressures to go up to where your well pressures are, then you think that that would help protect the migration from your leases? A. Yes.

Q. So if we just shut-in the field for 10 or 15 years it would stop it? A. No, sir. You have to shut-in the other wells and let me produce.

Q. Well, if you shut all the wells in — shut all the wells in, ultimately the field pressures would equalize? A. Yes, but there's still some underproduction of Amoco's in the ground.

Q. Now, I believe you stated a minute ago in answer to my question that you haven't made any study as to the amount of migration that's occurring from your leases. A. No.

Q. Have you made any study as to the volume of allowable [141] that has been assigned to your wells as a result of your not producing your current allowable? A. Now, is your question in the form of the volume in a percentage of total? That was a — not a detailed study, but the accumulation of these underages have been cancelled and the accumulation of the underages that we have now, which is — of five months is an accumulation of that drainage now.

Q. Well, possibly you didn't understand my question. I asked have you made any volumetric determination of how much your allowables under the present proration formula have increased as a result of the underproduction of your well. A. Our underproduction is increasing because of a combination of underproducing and higher

allowables. It's a combination of both. And I have not separated the two. I'm saving some blame for [appellant] Cities Service.

Q. Well, assume with me that you have a well in the Hugoton Field that has one percent of the deliverability. And you get an allowable assigned of 1,000 Mcf, you don't produce that allowable and your pressure goes up. You said the deliverability formula — Won't you get a higher allowable subsequently? A. Yes, sir.

Q. Have you made any determination how much your allowables have increased as a result of your pressures going up on [142] these wells due to underproduction? A. No.

Q. Well, how can you state, sir, that all the reserves that you refer to in answer to Question 11 [page JA-57, *supra*] would have been lost if you had not had them reinstated? A. If I had not had them reinstated as the suggestion— change if they were in effect back at that time?

Q. Yeah. A. I said all of the reserves. All of that — Those exact Mcf would not be lost; part of them would be lost. And while we were losing those, the part that we did not lose would have been replaced by the future losses while we would be trying to operate under these rules and accumulating more underages and cancellations. So, I figured that one would balance the other.

Q. But, you didn't made any engineering study of that? A. No, sir.

Q. Do you — Do you agree, Mr. Feemster, that the allowables that the Commission fixes in the field are to the wells — producers [sic] wells and not to the purchasers? A. Yes.

Q. And, do you agree that the present formula assigns allowables to the wells based on their percent of deliverability in the field? A. They approach it, yes.

[143] Q. So, you're not complaining about the adjusted deliverability formula that's being used? A. No, sir.

Q. And, do you also agree that the allowables fixed by the Commission are — are permissive allowables; that they can't make Amoco produce them or they can't make [appellant] Cities Service buy them? A. That's the way I understand it.

Q. So, your problem is really with [appellant] Cities Service, isn't it, not this Commission? A. No, sir, it's with both of them.

Q. Why? If the Commission's formula, you agreed with me, is assigning allowables properly, why is your problem with the way the allowables are being assigned? A. If the allowables assigned would more approach what the purchasers are going to take, then my problem would be primarily with [appellant] Cities Service. But since it is both, my problem is with the high allowables and the low takes.

* * *

[145] *REDIRECT EXAMINATION* BY MR. PAULSON [Counsel for Amoco Production Company]:

Q. Mr. Feemster, is Amoco in favor of full production from all its Kansas Hugoton wells? A. Yes.

Q. And is the corporate position of Amoco that those wells should be to the extent they can produce the full potential of their productive capacity? A. We would like to produce as much as we can.

[146] Q. Has Amoco ever suggested to [appellant] Cities Service in any way that it should take less gas from the Hugoton so that additional gas might be taken from Wyoming or any other place? A. No, sir.

* * *

[147] Q. One last question. You're aware of the market demand hearings last month and the result of those

hearings, is that correct? A. Yes.

Q. And the fact that the field allowables were actually set in excess of nominations from the field? A. Yes.

Q. Now, what would be the effect of action such as that under Mr. Cook's plan on the ability of Amoco or any other underproduced operator to qualify to apply for [148] reinstatement of underage? A. Okay. We already have an inflated allowable. I mentioned earlier that it would have been twice as much as [appellant] Cities was going to take, and now it's 2.7, as I recall, times — after the Commission had adjusted it upward. Okay, this would be the basis for which we would be overproduced and become qualified to reinstate cancelled underage. A year from now, when the Commission establishes allowables for the next January, I don't know whether they would establish it up or down. But, if they establish it up again, we would — it would hurt us to qualify, or make it more difficult for us to qualify and would extend the period of time that — for us to qualify; even with a turnaround in [appellant] Cities [sic] purchases.

Q. So that even with a turnaround in the markets, you might be chasing the allowable in terms of trying to qualify under this plan? A. Yes.

* * *

[149] *CROSS EXAMINATION* BY MS. GORHAM [Counsel for Commission Staff]:

Q. Mr. Feemster, in your testimony, your Question No. 12 [page JA-57, *supra*]. Your answer to that question, first sentence, is, "Under existing rules allowing over- and underproduction of allowables which are prorated on the basis of individual interest in the field reserves, compensating migration of gas in place is permitted." Would you explain to me what you mean by "which are prorated on the basis of individual interest in the field reserves"? A. Your proration formula is

established to allocate production on the basis of reserves. Theoretically, it is developed that way. I feel that this formula in the Kansas Hugoton Field is as good or better than most that I've been involved with. And it probably is a reflection of the equitable, an equitable assignment to each individual well.

Q. So, you're saying that the allowables are assigned based on the reserves? A. The intent is to assign allowables based on a fair interest of each well in proportion to the total field reserves. And I feel that it probably is. I feel that it is.

[150] Q. Aren't the allowables assigned based on the wells [sic] deliverability rather than the reserves? A. You're talking about the formula. And this formula was developed by a lot of engineering and a lot of testimony that would result in an allowable approaching each individual wells [sic] share of the reserves. This was the intent. You're talking about the formula that brings us to that equity, or that fair share.

Q. So you're not equating the allowables with the reserves? A. Yes.

Q. Mr. Feemster, under the present policy regarding reinstating cancelled underage, is there any incentive for a purchaser to take more gas to make up underages? A. No.

Q. All right. Do you feel that the producer can instill any incentives in the purchaser to run more gas? A. I will say that there is some influence that we have. It's usually in our contracts. And we have very little in this Hugoton contract. Now, I'm going further. I don't believe I'll have any more if you adopt these rules either. I don't think I will have any more influence with our purchaser. I, in fact, I'm afraid that you may have — you have eliminated one of the — let me say weapons — that I can use. My purchaser may be able to say, "Well, the Commission did it. And you didn't — We

didn't cause your loss. [151] We won't be causing your loss if they adopt this."

Q. Won't Amoco at that time be in a position to say, "Well, you had the opportunity to take this gas at one time and didn't?" A. Yes, but, they have that opportunity under a different set of rules.

Q. But, the opportunity was still there? A. Yes. It was there, but the knowledge was also there that I could get my reserves and they could get my reserves back under — by restablishing [sic] these, or we reestablishing these cancelled underages and then they could take it. We thought all along that we could do this in the future, but now you're saying that I can't.

Q. You're [sic] understanding that the staff is not proposing to do away with that altogether but rather to place limitations on the ability to reinstate underage, do you not? A. I have no quarrel with your theory.

Q. Okay. Has Amoco thought about what it's going to do at the end of the life of a well — there is suddenly a large volume of underage remaining that cannot be reinstated and produced due to the physical capabilities of that well? A. We keep — We're optimistic. We feel that we can recoup it. If we can't, then, well, that's life. But, we're [152] talking about a rule change now. That's going to do the same thing that nature or our inability will cause towards the latter years, or towards the latter life of the field.

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RECROSS-EXAMINATION BY MR. STUCKY [Counsel for Southwest Kansas Royalty Owners Association]:

• • •

[153] Q. Yeah, I see. Incidently, I don't know where I read it, perhaps in some of this testimony that's been prefiled here, but apparently some of the wells such as

yours that are producing maybe four or five or six — five or six days a month in recent years, did the — although the wells are producing gas, the pressure is increasing, is that right? A. On some of them, yes.

Q. How much on some of Amoco's wells? A. I don't have the information.

Q. Five or six pounds? A. I do know that some of them are increasing. I don't know how much.

• • •

[156] Q. Now, why don't you want higher allowables? A. It accumulates underage on our part and it does not restrict the people who have better market conditions. And they're getting further and further ahead of us.

Q. Well, why don't — How are higher allowables hurting Amoco? A. Because, all the higher allowable does is increase our underage. It doesn't increase our production.

Q. Well, how does that hurt Amoco to have your underage increased? A. It hurts Amoco because the other peoples [sic] allowables are increased and they're producing more gas. More of this drainage away from us occurs.

• • •

[163] BY MR. BYRD [Counsel for Mesa Petroleum Company]:

• • •

[165] Q. Well then, from your experience as an employee of Amoco with the various fields that you produce gas in, most of which — and I've agreed are stricter — less flexibility than you have here in Hugoton, do you feel that the purchasers pay any attention at all to field rules? A. If the field rules help us in complying?

Q. I asked you if the purchasers pay any attention to it in their takes? A. Yes and no.

Q. Well, where is it — Explain the yes part of your answer. A. Okay. Where the field rules and the assignment of [166] allowables help us to enforce our contract with them, yes, they pay a lot of attention to it. If it does not assist us, then they are not as — Well, they're not enforced to comply with the Commission allowables.

* * *

EXCERPTS FROM TESTIMONY OF GARY D. HANCOCK

[171] *GARY D. HANCOCK* [Witness for Northern Natural Gas Company], being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified on his oath as follows:

* * *

DIRECT EXAMINATION BY MR. McCARTHY [Counsel for Northern Natural Gas Company]:

* * *

[174] COMMISSIONER DICK: Are there any objections to Exhibit Nos. 4, 5, or 6? None appearing the exhibits will be admitted.

* * *

Is there any objection to Mr. Hancock's prefiled testimony being referred into the record at this time? It will be referred in.

(The prepared testimony of Mr. Gary D. Hancock, as amended, follows:)

* * *

[176] Q. Are you familiar with the Commission General Investigation Order issued in Docket No. C-164? A. Yes, I am.

Q. Will you briefly explain what the Commission is seeking in this docket? A. The Commission has requested that a general investigation be made to determine the effectiveness of the current policy with regard to overproduction and underproduction of gas from the Hugoton Field and the reinstatement of cancelled underage.

Q. Have you prepared exhibits which you intend to use in your testimony? A. Yes, I have three exhibits.

Q. I hand you what the court reporter has marked

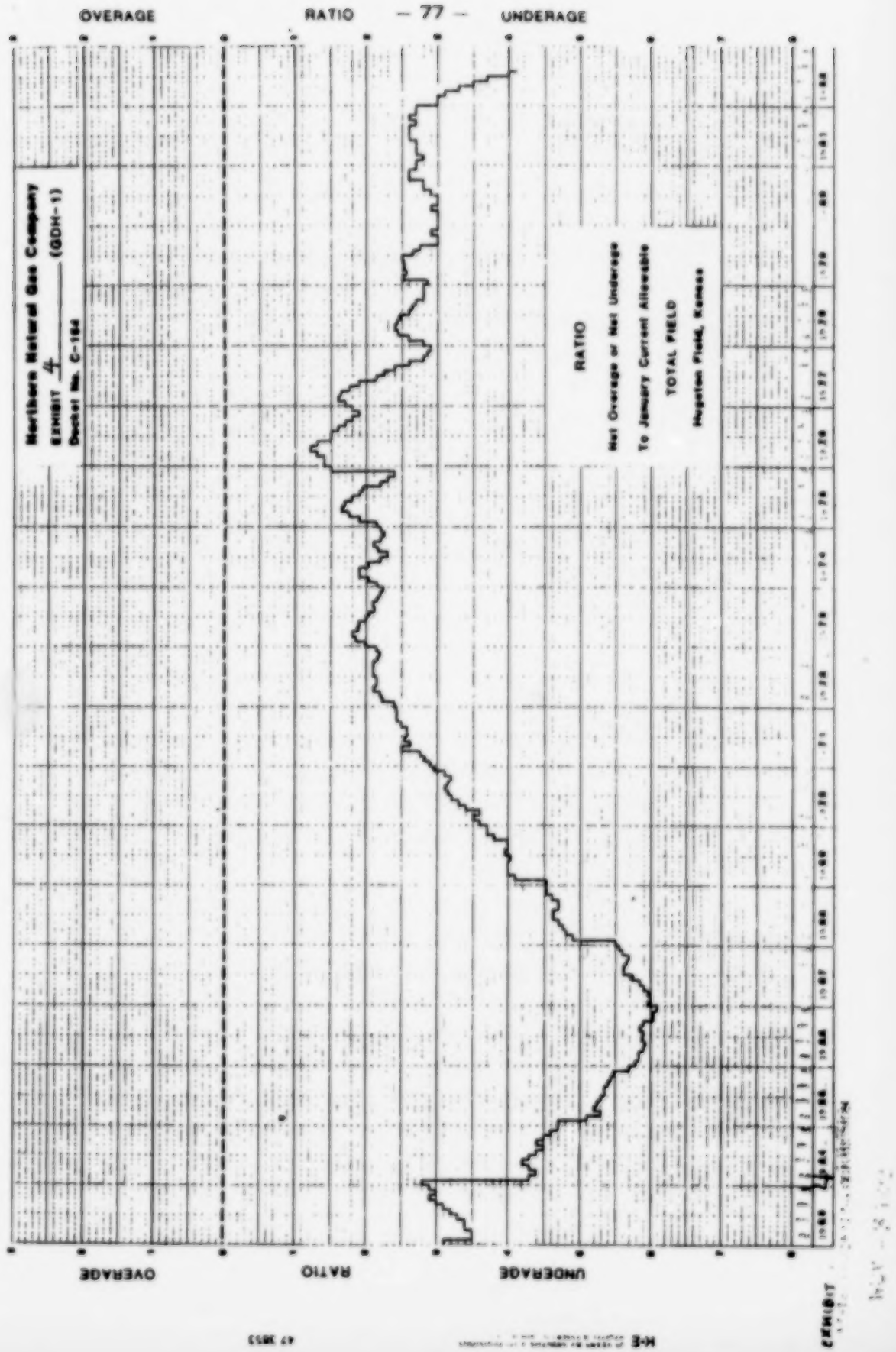
as Exhibit 4 (GDH-1). Will you please explain it? A. Exhibit 4 (GDH-1) is a graph showing the total Kansas Hugoton Field status commencing in 1963 and continuing through August, 1982. As can be seen, the field has been underproduced for the entire period. As of September 1, 1982, the field was underproduced in the amount of 204.5 Bcf which is 4.1 times the January 1982 basic allowable.

Q. What is the significance of this underage problem? A. The 204.5 Bcf of underproduction means that the majority of the wells [177] in the field have not produced the assigned allowable. At the same time, there are many wells which have overproduced the assigned allowable. If this situation is not corrected, correlative rights will be violated.

Q. How is the Commission's staff proposing to solve this situation? A. The Commission's staff is proposing to modify paragraph (p) of the Basic Proration Order.

Q. Will this solve the problem? A. No, it will not. The staff is recommending a change in administrative procedures which will on paper solve the underage problem. But it in no way will solve the problem regarding the violation of correlative rights, which is a major responsibility given the Commission.

Q. What can the Commission do to solve the underage problem? A. The real cause of the underage problem is that the allowables have continuously exceeded the runs from the field. Currently the purchasers are required to make monthly nominations of their market demands from the field. To solve the correlative rights problem, these monthly nominations should be adjusted for prior month actual runs and used as the current allowable. In making this adjustment, the difference between the prior month's net allowable and the actual takes for that month should be added to (in the case of overproduction) or deducted from (in the case of under-



production) the current month's nominations to determine the current allowable.

* * *

[179] Q. Please summarize the need for your recommended change. A. The Commission has the obligation to protect correlative rights. Under the current method of fixing allowables, the continued variance of the status between the individual wells will result in the violation of correlative rights. To avoid this variance between the wells, the Commission must limit the runs from the field to the true market demands for gas as reflected by the actual purchases.

* * *

[180] *CROSS-EXAMINATION* BY MR. DALE STUCKY [Counsel for Southwest Kansas Royalty Owners Association]:

* * *

Q. Going to Page 3 of your prepared testimony [page JA-76, *supra*], you say in answer to the question about whether the staff's proposal will solve the problem — What problem are you talking about? A. Underage.

Q. Underage. If this situation is not corrected, you said on Line 3 of that page, "Correlative rights will be violated." A. That's right.

Q. Now, would you explain that, please? A. Well, the sum of the wells in the field are allowed to produce more gas than their proportionate share of the reserves. If that practice continues, you'll set up lower pressures in those areas and gas will drain from the wells that haven't produced as much. That will [181] cause violation of correlative rights.

Q. I don't quite understand what you're getting at there. Would you mind repeating that? A. Well, if the — if the current practices continue of the assigning

allowables [higher] than the actual requirements out of the field, that allows certain wells to be produced at higher — more of their reserves produced, that lowers the pressure on those wells. Those wells that don't have a market for the gas that are — Connected purchasers that don't have a market for the gas, the gas from those wells would drain to the ones that do have a higher market.

Q. Well, are you talking about the correlative rights of the producers or the pipeline companies? A. The producers.

Q. Well, now, the correlative rights are the rights — the right to produce the gas, is that correct? A. Well, correlative rights is right to produce the reserves underneath the particular acreage.

Q. Well, it's a right to produce, that's what it amounts to? A. Well, I don't know legal interpretation of it. To me it would be the right to produce the reserves that underline [sic] that acreage.

Q. Underlining [sic] the field? A. That's right.

[182] Q. Well now, if given the right to produce the reserves on a proportionate basis, how are correlative rights violated? A. They're not being produced that way.

Q. But, that's not the Commission's. The Commission can't guarantee that he will produce the gas. If the Commission gives them a right to produce the gas, what more can the Commission do? A. Well, I think, the Commission has an obligation to protect correlative rights as best they possibly can. By allowing that practice to continue, that's not protecting correlative rights.

Q. Well, let me use — maybe get a hypothetical case. Supposing you had a field, forget the Hugoton Field, an order like this. You had two pipeline companies in it — two pipeline companies in the field each producing their own gas. And allowables were granted like under this order, but one company did not sell any

gas to speak of or didn't take out any to speak of, but the other company had a capacity to take out half of the gas and half the acreage. Now, what do you think the Commission's duty in that kind of a situation would be? A. To bring the pressures down at a uniform manner. In other words, allow the field to be produced based on the requirements of both pipelines, not just one [183] pipeline.

Q. And, if the market demand that the one company had was very very small, then you would say the Commission was obligated to keep the allowables way down so that it would get half the gas and the other company would get half the gas? A. Well, it would depend totally on the contract rules that would be involved in that field that you're talking about, the hypothetical field. But, they should bring the wells more into balance so that the pressures are depleting in a more orderly fashion to protect correlative rights.

* * *

[186] BY MR. BYRD [Counsel for Mesa Petroleum Company]:

Q. Mr. Hancock, I'm interested in your answer to Mr. Stucky's [187] question where you have one field with two purchasers, half of them are connected to — or one of them is connected to half of the wells and one connected to the other half of the wells. One purchaser had a market requirement from his customer of, let's say, 300 million during the next six-month period, and the other purchaser had none. Now, do I understand you to say that the market demand from that field should be zero? A. No, I think there ought to be a balance though between the two requirements.

Q. What do you recommend, sir? A. I would, at that point, look at possibly 150 as being something reasonable.

Q. Well, now, wouldn't that mean that the pipeline company that had another market requirement of 300 could not satisfy its market requirement? A. That's true.

Q. Do you read the Hugoton order to require that the Commission determine what the true market demand is from a reservoir? A. Yes, sir.

Q. What is the true market demand from that reservoir, Mr. Hancock? A. I'd say it's something close to the sum of the nominations.

Q. Three hundred. But, you have said that we ought to fix [188] the allowable at 150. How's the Commission complying with the statute? A. In that case there would obviously be a violation of correlative rights that would go on. After an adjustment —

Q. Excuse me. If the Commission assigned the allowables to those wells based on the deliverability under the formula similar to Hugoton, that would violate correlative rights? A. No, but, if the —

Q. Did you say no? A. — if the production was continued, no production out of one purchaser and —

Q. Now —

COMMISSIONER DICK: Might let the witness respond, Mr. Byrd.

MR. BYRD: But, I'm having trouble with terms.

Q. Let's talk about the Commission assigning allowables under the proration formula. A. Okay.

Q. Would you agree with me that they have an obligation to assign the allowables in a way that is equitable and fair and let's [sic] each producer produce its proportionate share of the reserves underneath its lease; is that what the statute says? [189] A. That's correct.

Q. All right. When they assign allowables under a formula such as the Hugoton formula, do you think they do that? A. Currently?

Q. Yes. A. Not when they set it higher than what the nominations are.

Q. Well, why? Why is that that they haven't permitted each well to produce? Do they have any control over production? A. Yes, sir.

Q. How? A. By the assignment of allowables.

Q. They have assigned the allowables in a manner that's proportionate to the wells — individual wells [sic] reserves. A. That's right, but not in proportion to the requirements from the field.

* * *

[191] Q. Well now, so you think the Commission [sic] statutory obligation goes further than assigning permissive allowables to protect correlative rights. Do you think it goes to making purchasers or producers produce? A. No, sir, I didn't say that.

Q. Well then, why haven't they fulfilled their statutory obligation when they've assigned allowables according to the basic proration order? A. By assigning allowables higher than what the requirements are, they are causing a violation of correlative rights.

Q. You don't think they cause any violation of correlative rights when they assign the allowables less than the producers have a market for? A. In this situation, no, they wouldn't.

Q. I see. So, you think the assignment of the allowables at a figure much less than the producers could sell does not violate correlative rights? A No, I do not think it does. Not when the field is underproduced as it is today.

Q. I'm talking about a hypothetical field. Say Northern [192] wanted 300 million and really had to have it out of this field and you only got 20 million. Do you think that may be a violation of the Commission's statutory obligation of the statue [sic]? A. I don't think they

have any obligation or anything. I'm not a lawyer as Mr. McCarthy will tell you. But, I don't think they have an obligation to worry about our customers. They have an obligation to worry about that field.

Q. Okay. So, if in this hypothetical field they would assign 150 even though there was a 300 million market, you think they would fulfill their obligation? A. I'm sorry, I misstated that, Mr. Byrd. I was assuming it was split half when we were talking about that. They should assign the 300 that's based on the market demand, the nominations. That would be the split then that, I assume, by some formula which would give the one purchaser 150 and the other 150.

Q. And, you do that even though you knew that the one purchaser wasn't going to take anything? A. Yes, sir.

Q. Now, you recommend in your testimony a counter proposal to staff's. Mr. Stucky asked you about it a little bit. Do you agree with me that what you recommend is the allowable would always be adjusted, the runs one month delayed? A. Yes.

[193] Q. So, the pipelines would set the allowable? A. Yes, sir.

Q. Can you find anything in the statute that says the Commission's supposed to let the pipelines set the allowable? A. No, again, not a lawyer, but we are the ones with the markets.

Q. I see. Are you telling — What's Northern paying for gas in Hugoton? A. Around 50 cents an Mcf.

Q. Are you telling me in this record that there is not a market for 50 cent gas? A. Well, that's, you know, that's the way we price it. We price it on rolled in.

Q. Do you think you could sell 50 cent gas? A. Oh, absolutely.

Q. And you've got a lot of it out there that's available for production. A. That's right. A lot everywhere available for production.

Q. And, you say there is a market for it? A. Absolutely.

Q. What's the problem? A. We sell it on a rolled-in basis.

Q. Do you have to? A. Yes, sir.

[194] Q. Who sets that policy? A. The Federal Energy Regulatory Commission.

* * *

[195] Q. Now, you don't have any qualms about turning the proration of gas in the Hugoton Field over to the pipelines, which you and I agreed that your proposal would do, one month delay? A. No, sir, that's the way it should be.

* * *

Q. Are you familiar with the fact that in the mid-'50's Northern was grossly underproduced under the formula? [196] A. I know we were underproduced in the mid-'50's. I didn't realize it was under the formula.

Q. Well, it was under a method where the runs were adjusted one month — or the allowables — current allowables adjusted for runs one-month delay like you're proposing. A. Well, I have no knowledge what the field status was. I know Northern was under.

Q. Do you think that your recommendations to adjust for runs one-month delay would be an incentive for purchasers to run more gas? A. No, sir. You know, we'd love to — Northern Natural Gas would love to be producing every cubic foot of gas we could to — make my job a lot easier. We just don't have the markets right now.

* * *

[198] BY MR. GLAVES [Counsel for Panhandle Eastern Pipeline Company]:

* * *

[199] Q. Well, if there's less allowable available, isn't that going to put the overproduced wells in a greater overproduced position? A. Absolutely, yes, sir. As it should.

Q. Well, aren't you in effect penalizing wells that don't have accumulated underage? A. Well, you know, what it does is it brings down the production — the allowed production rate on overproduced wells more in line with the average status in the field, which would be the best way to protect correlative rights.

* * *

Transcript of testimony taken before the Kansas Corporation Commission, November 4, 1982, at Wichita, Kansas [Record Vol. 10].

* * *

EXCERPTS FROM TESTIMONY OF LESTER WILKONSON

[2] *LESTER WILKONSON* [Witness for Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum Inc.], being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified on his oath as follows:

DIRECT EXAMINATION BY MR. BROCK [Counsel for Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum, Inc.]:

* * *

[5] COMMISSIONER DICK: Are there any objections to Exhibit Nos. 7 through 12? They will be admitted.

Is there any objection to Mr. Wilkonson's prefiled testimony being referred into the record at this time? It will be referred.

(The prepared testimony of Mr. Lester Wilkonson, follows:)

* * *

[7] Q. Mr. Wilkonson, have you studied the prefiled testimony of Mr. Cook, the staff witness? A. Yes, I have.

Q. How would you generally classify, or in what categories would you place his testimony? A. In my opinion his testimony may fit several categories. The categories that come to my mind are: 1. It makes recommendations that are cosmetic. It cleans up the monthly Hugoton Gas Report so that it looks better and it appears that the over and under position between purchasers and operators is in better balance. 2. It fits the category of what might be termed the ostrich approach. In other words, if we don't see it, it isn't there. 3. It also

takes on the appearance of a numbers game. If you move the numbers around and hide the numbers enough, you lose track of who has lost or gained and [8] what correlative rights have been lost in the shuffle.

Q. Mr. Wilkonson, you are not trying to ridicule or make light of Mr. Cook's testimony are you? A. Indeed not. I think we must remember that we still have a great field with minimum remaining recoverable reserves of approximately nine trillion cubic feet of gas. I am greatly concerned that we may be on the verge of abandoning sound proration practices that may result in the violation of correlative rights. I believe the proration formula that grants allowables to wells in the Hugoton Gas Field is the best formula that we can devise for that particular field. The allowables granted to the wells are determined according to that formula to protect the correlative rights of the various royalty and leasehold owners by permitting each lease ultimately to produce an amount of gas approximating the gas underlying that lease and to protect each lease against uncompensated cognizable drainage. To grant allowables necessary for this purpose and then to take them away under any pretense, other than voluntary action on the part of the producer or some factual finding that cancellation is justified from an individual well owing to its inability to produce, in my opinion, will result in the violation of correlative rights.

* * *

[14] Q. In answer to Question 30 in his testimony [page JA-35, *supra*], Mr. Cook states that "If" his proposed amendments provide an incentive for the operator to produce and the purchasers to take more gas from the underproduced wells, the underage situation will be improved in the field. In your opinion, will the proposed amendments provide such incentive? A. In my opinion,

this is the first time in his testimony that Mr. Cook has faced the reality in realizing that only the producing and taking of gas will result in any improvement in the underage situation in the field. However, it is also my opinion that the proposed amendments will not provide such incentive. As far as [15] the producer is concerned, the incentive is already there. He wants an allowable and to run the gas. This is the only way he can obtain revenue. Certainly, this is the only way the small independent producer can obtain revenue, and hence the producer is not the problem. As far as the purchaser is concerned, economics again dictate its actions. If the choice, due to lack of present markets, is between paying for expensive gas not taken under take or pay contracts and incurring permanently cancelled underage to connected Hugoton wells, I have no doubt the choice will be to incur the cancelled underage — as presently appears to be the case. This cancellation does not affect present cash flow or profits of the purchaser, and any loss of connected reserves may be made up from from [sic] future dedications from other sources. In any event, at this time, there is no shortage of available gas. As a result, the pipeline purchaser will suffer little, if any, by Mr. Cook's proposals. The damage will be done to the producers and royalty owners of wells suffering cancelled underage and the correlative rights of those producers and royalty owners.

* * *

Q. [16] Q. Mr. Wilkonson, will you explain what is happening to the deliverability of wells connected to a purchaser who is not taking gas as compared to wells connected to a purchaser who is taking allowables and possibly overproducing. A. If wells are produced far below their allowables, the well pressure generally will suffer less decline, and therefore the deliverabilities will

generally remain higher than the wells that are producing their allowables and perhaps are overproducing. This will result in higher allowables to wells that are underproducing than would otherwise be the case.

Q. What happens in the reservoir while this is going on? A. The wells that are being produced at rates approximating their allowables or in excess thereof will have lower formation pressures and if this exists over a period of time, drainage to those wells will occur.

Q. Are there examples of such conditions existing in the field today? A. Yes, such conditions can be observed from readily available information.

Q. I hand you what has been marked by the reporter as [17] Exhibits 8 and 9 and ask that you identify and discuss what these exhibits, in your opinion show. A. Exhibit 8 is a tabulation that is prepared yearly by Mr. Kenneth Beakey of this Commission after the yearly testing of wells has been completed. It shows the average well head shut-in pressure for the wells which are either directly connected to or are selling gas to a purchaser through the gathering system of a producer. It should be noted that the average pressure of the wells connected to El Paso, Mesa, and Panhandle Eastern are considerably below that of wells connected to other purchasers. As shown by Mr. Beakey's figures, this condition has continued for at least seven years and generally seems to be getting worse. This fact of itself may not be meaningful until it is possible to view the position of those wells with respect to wells of other purchasers. As heretofore stated, this exhibit was prepared by Mr. Beakey. Exhibit 9 was prepared by me and is a map of the Hugoton Gas Field on which the wells connected to each purchaser have been color-coded so that their relative positions may be easily identified. Wells colored solid red are the wells connected to El Paso with average 1982 wellhead shut-in pressures of 141.3 psig. The

majority of these wells are surrounded by wells connected to [appellant] Cities Service, shown by the green color, [18] with average 1982 WHSIP [Well Head Shut In Pressure] of 170.9 psig. A few of the wells are adjacent to the Mesa wells colored yellow.

Wells colored yellow are the Mesa wells with average 1982 WHSIP of 134 psig. This concentrated block abuts wells connected to a number of purchasers such as [appellant] Cities Service in green, Panhandle in orange, El Paso in red, Colorado Interstate in brown, and Northern Natural in blue. As will be observed from Exhibit 8, the average pressure of the wells connected to the purchasers mentioned, which abut the Mesa wells, are considerably higher, with the exception of Panhandle.

Q. Mr. Wilkonson, let me interrupt your discussion and ask if you infer any wrongdoing on the part of either El Paso, Mesa, or Panhandle because the average pressure of wells connected to their systems are lower than the average pressures of the wells in the systems they abut? A. Indeed not. Although they may be overproduced, they are generally well within the limits of the Hugoton Gas Field Basic Proration Order. The purpose of my testimony in this regard is to show the presence of drainage which is occurring from the areas of high pressure to the areas of low pressure. Compensating drainage can occur for the underproduced wells only if they are permitted ultimately to produce their assigned allowables.

[19] Q. Will you please proceed with your discussion of Exhibits 8 and 9. A. The other system heretofore mentioned as having an average pressure substantially lower than the others shown on Exhibit 8 is Panhandle Eastern. Of the wells connected to Panhandle, some are overproduced and a few are having some underage cancelled. As late as October 1981, the total system status was shown as overproduced. The Panhandle connections on Exhibit 9 are shown in orange color. They have con-

centrated blocks of wells which generally are surrounded or abut wells connected to systems with higher average pressures. In my opinion, the pressure evidence shown on Exhibit 8 along with Exhibit 9 demonstrates how gas drainage can and does occur.

Q. How can uncompensated cognizable drainage between separately-owned developed leases be prevented when such conditions exist? A. This can be prevented only if a well is permitted to ultimately produce the full allowable that has been assigned it. At such time as conditions result in the taking of the allowable and at the same time make up underproduction, the deliverability and pressure of the underproduced well will decline. The current allowable to the well will be lower permitting the make up of underproduction and at the same time the formation pressure of that well will be lowered and [20] compensating drainage will occur. This is the manner in which the deliverability formula was designed to work and the way it does work. I must again caution that an inflexible requirement to make up underage in a short period of time will not, in my opinion, permit the reservoir to function as it should; hence, the make up preferably should occur over about the same time frame as the underage accrued.

Q. If underage is permanently cancelled, will this have an effect on the compensating drainage which the deliverability formula is designed to provide? A. Yes. After the underproduced well or lease has suffered drainage, the permanent cancellation of underage cuts off its right or opportunity later to obtain compensating drainage. The permanent cancellation of underage precludes by Commission rule the balancing of the correlative rights. The Commission may not be able to force another party to prevent drainage in the first instance, such as force a producer or mineral owner to drill an offset well or by direct order force a purchaser without a

market to run gas, but the Commission itself should not cause or contribute to uncompensated cognizable drainage as a part of its regulation.

Q. Is it your opinion that all of the underage can ultimately be made up? A. No, I recognize that there are some wells that will be [21] unable to produce current allowables plus make up underage. Some wells that receive near to or minimum allowances could produce their allowable if the gas were taken currently, but if not taken currently some of the underage may never be produced. However, it is obvious that the vast majority of the cancelled underage is on wells which are capable of making up the underage if given the opportunity. In this connection, it should be pointed out that the vast majority of cancelled underage is on the larger wells and not from wells that generally receive minimum allowables. None of the wells which are able to make up their underages should be denied the opportunity.

Q. I hand you what has been marked by the reporter as Exhibit 10 and ask you to identify and discuss that exhibit. A. This is page 7 from the September, 1982, Hugoton Gas Report. It reflects the almost total lack of runs by [appellant] Cities Service from a number of Amoco wells, with the resulting cancellation of underage. The size of the wells suffering cancellation and the magnitude thereof is of particular interest. Obviously, most of the cancellations of underage are from the larger wells rather than the minimum wells as the minimum wells have little allowable to contribute toward the so-called underage problem.

[22] Q. Do you have an opinion as to the inadvisability of cancelling underages based on considerations other than correlative rights? A. Yes.

Q. What are those considerations and what is that opinion? A. The Commission will find in its files great

volumes of testimony and reports and recommendations from committees concerning underproduction. We have gone through periods when moratoriums were in effect and no underage was cancelled. Too, the flexibility limits of cancelling underproduction and overproduction have also been changed from time to time. As long as underage could be reinstated, no one had serious objection to the cancellation provisions. However, I personally have felt that cancellation of a portion of underage actually removed the "heat" from the purchasers to take gas. In other words, if the public record reflects only a portion of the underage, the purchaser's takes do not appear to be too far out of line. In my opinion, if any change is to be made in the cancellation provisions of paragraph "p," it should be to place all underage, both present and cancelled, back on the report so we may take our heads out of the sand and see the true status of the individual wells connected to the various purchasers.

[23] Q. If all of the underage, including previously cancelled underage is placed on the Hugoton Gas Report, do you envision any immediate benefits in the field that may occur from the use of this information? A. Yes. This information could be quite helpful to put pressure, including possibly present economic pressure, on the purchasers whose connected wells are underproduced to run more gas from those wells.

Q. Which purchaser is the most guilty of permitting underages to accumulate on its system? A. [Appellant] Cities Service Gas Company.

Q. I hand you Exhibits 11 and 12 and ask you to identify and explain these exhibits. A. These exhibits were prepared by me. Exhibit 11 is a comparison of monthly runs by [appellant] Cities Service Gas Company from the Hugoton Gas Field for the calendar year of 1981 and thus far in 1982. Exhibit 12 is a tabulation of yearly pressures and takes from the field for the years

1957-1981 for the Cities Service system. These exhibits show that [appellant] Cities Service has decreased its takes from the Kansas Hugoton Field from 267,524 MMcf for the yearly period ending July 1, 1970, to 172,934 for calendar year 1977, to 102,347 for calendar year 1981. In fact, the average pressure on the system actually increased from 1980 to 1981 because of the limited takes. Then, in the [24] calendar year of 1982 through August, [appellant] Cities Service has run only approximately 36 percent as much gas as it ran in the same months of 1981. It is apparent from these two exhibits that [appellant] Cities Service has virtually ceased taking gas from the Hugoton Gas Field. Reference to Exhibit 9, the colored map of the field, quickly discloses the vast number of of [sic] wells shown in green which are connected to [appellant] Cities.

Q. How could the disclosure of all underage on the Hugoton Gas Report be used to pressure [appellant] Cities Service, or any other purchaser with excessive underage in its system, to run such underage? A. I have already stated that I have always believed that cancellation of a portion of underage and removal of that underage from the Hugoton Gas Report removed the "heat" from the purchaser to take gas. It tends to conceal the true situation in the field.

Also, I understand that the Kansas Corporation Commission is protesting a price increase proposed by the [appellant] Cities Service Gas Company for its gas to distributors selling gas to users in Kansas and other nearby areas. If the Commission were armed with their own Hugoton Gas Report showing billions of cubic feet of gas, including underage gas, available for [appellant] Cities Service to run at low prices, this should have some impact on federal authorities.

[25] This information could also be quite useful together with other information to show a compelling

need for faster depletion of the Hugoton Gas Field. In information filed with the Kansas Corporation Commission, [appellant] Cities indicates that on the basis of 1981 takes from the Hugoton Field, [appellant] Cities had an overall remaining life index of 28 years, and that gas purchased at the wellhead from 1,034 wells had a reserve life index of 35 years. The Commission has had frequent requests for replacement well allowables as the result of casing failure in older wells. The wells in this field will not last the additional years required for depletion at the rate [appellant] Cities took gas in 1981. This Commission is aware that under the present scheme of things the drilling of replacement wells results in higher-cost gas. Of course, the producers are aware that the drilling of replacement wells is also very costly.

Another situation mentioned at the last Hugoton market demand hearing was the possible shortage of gas to KP&L from Mesa. KP&L did not testify about this matter, and therefore the shortage may not be as acute as it appeared. At any rate, remarks made at the hearing would indicate that [appellant] Cities would sell gas to KP&L at a price of $4 per Mcf. Since [appellant] Cities has no need for the Hugoton gas and has announced no intention of increasing takes on a [26] sustained basis, it appears that the Kansas Corporation Commission should ask federal authorities to order or in some fashion cause [appellant] Cities to sell needed gas to KP&L at either a reasonable negotiated price or at their cost plus a reasonable gathering and delivery charge. At least, the Commission should investigate the possibilities of forcing some type of action through the federal authorities and the true picture concerning the gas available to [appellant] Cities Service should be quite useful in this effort.

* * *

HUGOTON FIELD KANSAS
AVERAGE WHSIP [PSIG] & DECLINE
1975 THROUGH 1982

Connection	1975 Average	1976 Average	1976 Decline	1977 Average	1977 Decline	1978 Average	1978 Decline	1979 Average	1979 Decline	1980 Average	1980 Decline	1981 Average	1981 Decline	1982 Average	1982 Decline
Cities Service	204.7	200.2	- 4.5	194.9	- 5.3	186.5	- 8.4	175.2	-11.3	170.9	- 4.3	169.1	- 1.8	170.9	+ 1.8
El Paso	189.8	177.5	-12.3	181.6	- 4.1	161.4	-20.2	154.4	- 7.0	143.5	-10.9	144.6	+ 1.1	141.3	- 3.3
C.I.G.	219.3	210.7	- 8.6	205.4	- 5.3	196.8	- 8.6	183.4	-13.4	180.5	- 2.9	182.4	+ 1.9	185.5	+ 3.1
Kansas-Nebraska	226.2	219.2	- 7.0	198.5	-20.7	197.3	- 1.2	193.7	- 3.6	188.5	- 5.2	182.5	- 6.0	178.4	- 4.1
Mesa Petroleum	172.4	164.5	- 7.9	159.4	- 5.1	155.7	- 3.7	148.9	- 6.8	140.8	- 8.1	132.5	- 8.3	134.0	+ 1.5
Northern Natural	207.4	200.1	- 7.3	197.8	- 2.3	192.1	- 5.7	181.4	-10.7	176.2	- 5.2	173.3	- 2.9	164.1	- 9.2
Panhandle Eastern	188.4	177.9	-10.5	180.6	+ 2.7	173.2	- 7.4	160.5	-12.7	154.3	- 6.2	146.0	- 8.3	139.1	- 6.9
Miscellaneous	216.9	209.2	- 7.7	188.3	-20.9	191.0	+ 2.7	183.1	- 7.9	184.9	+ 1.8	185.1	+ 0.2	174.1	-11.0
TOTAL FIELD	204.8	197.7	- 7.1	193.4	- 4.3	186.6	- 6.8	176.0	-10.6	171.1	- 4.9	167.9	- 3.2	164.7	- 3.2

Exhibit 8
Admitted
November 4, 1982

Cities Service Gas Co.
Pipeline Runs - MCF

Month	1981	1982
January	14,491,435	10,348,162
February	12,688,789	9,531,537
March	12,390,584	3,053,805
April	9,495,323	3,924,052
May	8,889,912	1,030,278
June	8,649,430	549,131
July	8,876,257	525,651
August	7,580,861	807,261
Sub Total	83,062,511	29,769,877
September	4,997,043	
October	2,917,515	
November	4,313,149	
December	7,056,934	
Total	102,347,232	

Exhibit 11
Admitted
Nov. 4, 1982

CITIES SERVICE

Date	Pressure Psig	12 Month Production (MMCF)	Cumulative (MMCF)
7-1-57	360.76		1,067,255
7-1-58	353.34	131,250	1,198,505
7-1-59	346.74	122,460	1,320,965
7-1-60	339.40	146,431	1,467,396
7-1-61	327.47	157,671	1,625,067
7-1-62	320.38	165,231	1,790,298
7-1-63	313.06	174,692	1,964,990
7-1-64	309.3	182,495	2,147,435
7-1-65	299.12	202,665	2,350,100
7-1-66	289.74	211,994	2,562,094
7-1-67	281.6	219,495	2,781,589
7-1-68	272.7	217,772	2,999,361
7-1-69	262.6	231,992	3,231,353
7-1-70	250.0	257,524	3,488,877
7-1-71	235.44	267,453	3,756,330
7-1-72	223.3	267,203	4,023,533
7-1-73	218.3	237,343	4,260,876
7-1-74	211.0	212,824	4,473,700
7-1-75	205.0	183,780	4,657,480
7-1-76	200.2	166,647	4,824,127
1-1-77	194.9	81,820 (6 Mo.)	4,905,947
1-1-78	186.5	172,934	5,078,881
1-1-79	175.2	173,672	5,252,553
1-1-80	170.9	150,483	5,403,036
1-1-81	169.1	110,513	5,513,549
1-1-82	170.9	102,347	5,615,896

Exhibit 12
Admitted
Nov. 4, 1982

[28] *CROSS EXAMINATION* BY MR. DALE STUCKY [Counsel for Southwest Kansas Royalty Owners Association]

* * *

[36] Q. Is there any other reason that the cancellation of underage removes heat? A. I can't see that — I don't know. Tell me what you're asking me?

Q. Well, I'm just — We're all concerned about the fact that the Hugoton Field is not being produced ratably in connection with other fields to which the various systems are connected. A. I'd join in that.

* * *

[50] BY MR. BYRD [Counsel for Mesa Petroleum Company]:

* * *

[52] Q. But actually the recent tests show that the pressures on some of the underproduced wells have gone up, isn't that true? A. Temporarily, yes.

Q. Yes. Okay. Now, you go on to say that when this happens this will result in higher allowables to the [53] wells that are underproducing than would otherwise be the case, is that true? A. Indeed.

Q. Now, in your answer to Question 18 on the same page [page JA-89, *supra*]; question being, "What happens in the reservoir while this is going on?" You answer that, "The wells that are being produced at rates approximating their allowables or in excess thereof will have lower formation pressures and if this exists over a period of time, drainage to those wells will occur." A. Absolutely.

Q. All right. What happens to those wells that are producing current allowables? What happens to their allowables over time? A. If they keep their pressures, their allowables are reduced as a portion of the field.

Q. Okay. Now, so we got — Let's talk about two wells to make it simple. We've got two wells that are

assigned allowables under the formula, properly. If they produce the allowables, they're going to get to produce their reserves and other acreage. Now, one well produces its allowable and the other well doesn't. I believe you stated that the pressure on the "B" Well that's underproduced will go up. A. I didn't say go up necessarily.

Q. Well, it'll be higher than it would have had it produced [54] its allowable. A. Indeed.

Q. And this results in it getting more allowable. Now, you say the "A" well that produces its allowable, its pressure will come down and it will be lower than the pressure on the "B" allowable, is that correct? A. Yes.

Q. And it will get less allowable. Now, you say if this happens over a long enough period of time, gas will migrate — start to migrate from the "B" lease to the "A" lease. A. From the well — I didn't get your "A" and "B".

Q. Well, I'll just call "A" — The produced well is No. "A". The underproduced well is "B". So it starts to migrate toward the "A" well, is that right? Do you know how much? A. Do I know how much of migration there is?

Q. Yes. A. Mr. Byrd, you would have to calculate this yearly.

Q. Have you done it? A. No, and no one else has done it. You can't do it. You would have to take every well in the field and calculate it yearly. Because, I can show you, for example, with the Mesa wells. They've gone from, say, 6 or 7 percent up to 11 percent total field and then they've [55] gone back down. So, every year you have individual wells changing positions according to how much gas is run or not run.

Q. You say it can't be done; it was done at the Oklahoma State line several years ago, wasn't it? A. No, that wasn't done on an individual well at all.

Q. Well, it was done across the State line. A. There were some statements made, yeah. But, you were looking at some — 50 some miles of width. I don't know that anyone ever felt like that was an absolute number in any sense. But, we knew there was drainage there and in some magnitude.

Q. And, there was an attempt to quantify the amount. A. There was an attempt.

Q. All right. Supreme Court believed it, didn't it? Now, unless you can quantify the amount that's moving from the "B" well over to the "A" well, we don't really know how much gas we're talking about, do we? When you say you can't quantify it. A. Well, I think we know that it's moving.

Q. I think everybody will agree that it moves from a high area to a low area. Now, what I want to ask you is can you calculate how much additional allowable that the No. "B" well got because it didn't produce its full allowable? A. No, I'll say this though; at such time as the "B" well [56] is permitted to produce its allowable it will bring its pressure down radically; it will lose allowable, in my opinion, in the same proportion that is [sic] gained allowable.

Q. I see. Is it possible to calculate how much additional allowable an underproduced well got over a period of time, five years, ten years, because it was underproduced? A. I don't know that you can quantify this. Someone might take those figures and rattle around with them if you knew permeability and everything.

Q. All right. But, if you knew — if you knew what the wells [sic] true percent of deliverability of the field was; in other words, if you arrived and, say, it was one percent, you could project under the market demand formula what its allowable would have been had it continued to get one percent of that demand, couldn't you? A. I'm not sure this would be a true way of doing it at

all. It's a simple — It sounds simple the way you explain it. But, you have to start out not just by deliverability. But you can drill four wells in the same section and get four different answers, as you know, on deliverability. And the deliverabilities will control what reserves you take out of the ground.

Q. Well, do you think there's any relationship between the [57] increased allowable to an underproduced well and the amount of drainage that might be occurring from the underproduced well to the produced well? A. I don't know.

Q. Okay. Well now, let's back and look at the reservoir. Does the reservoir know when a well's producing whether it's producing current allowable or making up underages? A. The reservoir reacts to these forces.

Q. It reacts to production, doesn't it? A. Yes.

Q. It doesn't react to whether it's reinstated underages or current allowable, does it? It doesn't; it just reacts to production. All right.

Now you stated a minute ago that if that underproduced well started to make up underages its pressuring is going to come down, is that right? A. Yes.

Q. And that's the only way you're going to stop the migration of gas if it's migrated. Well, because it was underproduced, its allowable has gone up; we've established that. If it just started producing its current allowable, wouldn't the pressure come down? A. From what it is today? Yes, it would come down.

Q. Wouldn't it eventually get back to the level with the "A" well? A. It's got to do better than get back with the level. It's [58] got to drain that gas from that other well, and the only way —

Q. Well, wait a minute, Mr. Wilkonson. I'm asking you will the pressure ever get back to the "A" well level. Now, remember, the "A" well is producing exactly its allowable, but its allowable has gone down because

its pressure is lower than the "B" well. If the "A" well continues to produce its allowable right on the button every month, the "B" well starts producing its current allowable; forget about underage. It starts producing its higher current allowable; will the two wells ever get the pressure equaled out? A. If the "A" well — the "A" well — no. The "B" well is the underproduced well. At that point, if it starts producing its current allowable? Well, I'll say this to you; it has lost some gas in the meantime so —

Q. But, it's gained quite a bit of allowable. A. Well, okay.

Q. Okay. A. But, the minute you start taking gas out of that reduced reserve you're going to drop faster than you would otherwise have dropped.

Q. So, the pressures will come back together? A. You'll get your pressure down but you won't counterdrain. [59] You won't get back compensated drainage.

Q. You get the pressure down to equal the pressure on the "A" well. A. But you've got to go below that to compensate the drainage that's taking place.

Q. But you can't quantify how much. A. I don't think anyone can quantify that. But, I'll say this; in my opinion, the way this formula works and the way you watch these wells work, you start taking fairly large volumes of gas out and your pressure drops mighty fast so you lose allowable. In my opinion, you lose allowable in about the same volume or ratio as you over-drain.

Q. Well, that's what I tried to establish with you first. I tried to see if you had established or made any study to determine whether or not there was a relationship between the gas migrating from the "B" well over to the "A" well, and the increase in the allowable that the "B" well got? A. Well, I don't know that you — Frankly, I haven't quantified this. But, I can tell you this; if you study enough wells out there all the time, you'll see when

you start overproducing the allowable of a well that's been underproduced, its pressure starts down mighty fast.

Q. It sure does. [60] A. And the only way you're going to get back the gas that's migrated is to produce your allowable plus the underage.

* * *

[74] Q. Well now, Mr. Wilkonson, if we got back to our hypothetical on the two — "A" and "B". If "A" well continued to produce its allowable and the "B" well continued to produce its allowable and the "B" well didn't produce its allowable but kept under the formula, getting assigned more, and the "A" well continued to produce, eventually under the field rules "A" would be shut-in, wouldn't it? A. I don't think it would ever get to zero allowable.

A. Well, don't you think its pressure would ever drop below the deliverability? Then it would have a zero allowable, wouldn't it? A. Well, let's not talk about it in terms of zero; you always have a minimum, you understand. But, I don't consider a minimum if we're talking about good wells.

Q. All right. A. I'll say this; if the thing went on as long as you're trying to presume it would go on, it would drain enough gas to keep a pretty good reserve coming all the time.

Q. That doesn't do it any good if it doesn't have allowable. A. But, if it continues to get gas by way of drainage, it's going to have something to deliver in the pipeline [75] to have a deliverability and get an allowable.

Q. Well, I suppose it could produce its minimum allowable. A. Now, I'm not talking about minimum; I mean something better than that. If you would go on in your hypothetical concept, and this went on for a longer period of years, your well that's producing its

allowable — having a lower pressure would continue to drain gas. Now, we hope — If you look at the Hugoton production company wells that they drilled; you know, they redrilled five wells out there and they left the old wells for observation wells. It gives you a pretty good idea what the difference in the inner well pressure is as compared to the wellhead pressure; the producing wellhead pressure. Those differential pressures are well within — some of them are suprisingly [sic] low and some of them are within maybe 15, 20 pounds of each other. So, you're getting gas fed from an inner well area into a well bore with maybe no more than 20 pounds differential; maybe as high as 50 pounds. If you do what you're talking about, you're going to have, I would guess, real good migration of gas to the well and you're always going to have an allowable, not the situtation you describe.

Q. But, it wouldn't have the allowable it would have had [76] the "B" well produced? A. It would not currently — no, it would not. On the other hand, remember the "B" well is going to lose allowable later on.

Q. Only if the — if it produces gas. A. That's right.

Q. Can the Commission make it produce gas? A. No, but it will in time. The Commission shouldn't take away its right to produce gas.

* * *

[79] BY MR. GRIMES [Counsel for Kansas Power and Light Company]:

* * *

[80] Q. So let's look at KP&L's problem from our viewpoint then. A. Yes, sir.

Q. If the formula that you say is the best we can design is not getting KP&L enough gas from its supplier, Mesa, what in your judgment can KP&L do? A. Well, KP&L's an intrastate system; they have limited themselves in their ability to acquire gas for their sys-

tem by — by keeping that — keeping their system intrastate.

[81] Q. That's historically true, isn't it? A. That's historically true, yeah. So, otherwise, you must try to find the sources of gas. You can go to [appellant] Cities or anyone that you can buy gas from, plus buy gas from wells that are drilled within the State.

Q. So, the bottom line of that self-help of KP&L is again as you pointed out in your direct testimony much more costly to KP&L's gas customers? A. It can be unless you trade harder.

Q. All right. Do you think that we could have traded harder and gotten 26 cent gas any place? A. Not 26 cent gas. I think you may have traded harder and gotten something below $4.00.

Q. Well, we're currently paying Mesa a low of 26, aren't we? A. Twenty-six cents? I thought you were paying them more than 26.

Q. The average is 67. Do you think we could have replaced some of that 67 cent gas when we went out shopping? A. No, but, you know, the facts of life are that you cannot continue to depend on Mesa; either now or in the future.

Q. When we buy FERC regulated gas, we've got to pay the FERC tariff, don't we? [82] A. I don't know that you do.

Q. But, you don't know the contrary to that? A. I do not.

* * *

[83] Q. Recognizing the [Kansas Corporation] Commission's jurisdiction over the Kansas Power and Light Company's resale of this gas that it purchases, which is a different hat perhaps than it has on today; do you have any recommendation beyond those that you propose in relation to this nomination process that would help

the KP&L customers with more cheaper gas? A. I don't know what — You mean market demand?

Q. Yes. A. No.

Q. Wouldn't the raising of the market demand above the current setting of 175 Bcf to, say, the 200 Bcf that you use in your example; doesn't that have a trickle-down benefit to KP&L's customers? A. Well, yes, if you just — this — If this would be the only fact that they would take into consideration, yes, you could just keep raising the allowable so Mesa — But, even with that; if you look at Mesa's pressures, they're going down, there's a limit to how much they can [84] borrow from the future too; it's either today or you're going to have something left over for tomorrow.

* * *

Q. And your philosophy of what's good for the field is perhaps expressed with more concern for the long term than you believe Mesa's position is expressed in? A. You mean the proposal that they've made where we would cancel everything and only have a year to make it up and that sort of thing?

Q. Yes. A. Well, yes, indeed. Mesa's lived by a different sword themselves; they have time to make up underage. Now, they come in and want a short time on everything for everybody else.

* * *

[85] BY MR. MARTIN [Counsel for Kansas-Nebraska Natural Gas Company]:

Q. Mr. Wilkonson, would you refer to your map [Exhibit 9] that you had reference to earlier there laying on the table? A. Yes, sir.

Q. Would you amplify a little bit what appears from your earlier testimony about the significance of that map? What does it really show us in terms of the matter that we have in front of us? [86] A. Well, I think

the matter that we have in front of us seems to be generated mostly by the lack of [appellant] Cities takes in the field. There are some purchasers that have some problems, but not nearly this magnitude. If you'd look at the map and the green area covered; it's astounding that they actually control that much of the field.

Q. By "they", you mean [appellant] Cities Service? A. [Appellant] Cities Service, yeah.

The last thing that I had, they had about 37 percent of the total field deliverability. The reserves that they reported along with everybody else in the last — in the market demand hearing in January — or March of this year; if you add them all up, they had about 31 or 32 percent of the total reserves in the field. I have some graphs and I think they have a greater portion of the reserves than that. You look at the acreage and what they have, they have a terrible big impact on this field. And, I don't think that you can just throw away the — the impact that this has and start changing rules and say all of the acreage that is now tied to [appellant] Cities Service is going to vary much by a different set of rules than has been in effect in the past.

Q. There's been — A. Pardon me. I think the map shows that when you can look [87] at the colors and see the wide area that they actually serve in this field.

Q. You mentioned earlier that in your opinion they have dedicated more than the 31 percent shown by the map? A. In my opinion, I look at their reserves as being — that they may have almost 35 percent of reserves in the field.

Q. Now, there's been a suggestion tendered to you and some other witnesses by some of the Counsel here that one of the things that may be going on is that [appellant] Cities Services is quietly acquiescing in — or favor the purchase of gas from Wyoming or perhaps the Gulf Coast and in effect storing the gas in the Hugo-

ton Field. Do you remember that line of questioning? A. Yes, sir.

Q. Now, you've had a lot of experience in this field and with the — with the affairs of the Commission itself, have you not? A. Yes, sir.

Q. I think you said that you wouldn't at this point accuse anybody of that, but if in fact there's cause to believe that that's going on, do you know of any reason why the Commission couldn't undertake an investigation directed at those who they believe have [88] contracts or financial commitments elsewhere that actually cause them to do that rather than as distinguished from imposing an arbitrary cancellation rule that affects other — other pipeline companies and landowners and producers in this field that clearly aren't involved in that? A. Well, I don't know what the Commission's powers would be to be able to investigate a thing of that kind. But, as I say, I wouldn't accuse anyone of — I know they're take-or-pay contracts. And, I suppose that if you have a take-or-pay contract to sell gas, you'd be very reluctant to give up that right.

You know, a long time ago, Northern Natural came in before the Commission and asked to be able to overproduce their wells. They were not granted that permission. And they went out and bought gas from other sources. And from one year to another, I recall their runs were reduced from about 100 billion down to something like 50 billion. And so their wells for a period of time were badly underproduced. And from time to time everybody in this field has undergone this same situation. And, I don't think we need to be in a panic about changing rules because of this. Maybe [appellant] Cities ought to step forward some time and say, "Well, look, within [89] this period of time or that period of time we're going to be back where we'll be producing lots of gas from Hugoton"; maybe that's the way to get this. I don't think the rules ought to be changed.

Q. What you're really saying is that as far as [appellant] Cities is concerned, the impact on the field is huge because of the percentage of the field that's dedicated to their reserves? A. Yes, sir.

Q. Now, as I understand your testimony, you, as in line with several other witnesses, take the position that the basic proration formula that's been applied to this field over the life of the field is about as nearly perfect as we can get in terms of allowing each unit, or each well to produce the total amount of reserves that that unit is entitled to produce, is that? A. I think it does the best job that we can as humans devise on the thing.

Q. Now, by way of summary, do I understand that your position is that the permanent cancellation of underages such as is proposed by the present rule tendered by the staff is objectionable because indirectly it amounts to a frustration of or a tampering with the basic formula? A. I think that's a good statement.

* * *

[90] BY MS. GORHAM [Counsel for Commission Staff]

* * *

[93] Q. In your testimony you refer to the Commission asking the Federal authorities to order certain things to be done or to take certain actions; you're not implying that the Commission should turn over jurisdiction of the Hugoton Field to the Feds, are you? A. In no way. I don't think my suggestion in any way implies that they would do that. I think this would be an economic thing they would be taking to the Commission.

[94] Q. Are you implying that this would somehow provide a solution to the underage problem? A. Well, I think it would help.

Q. Could you explain that to me a little bit? A. Let's assume they — that our Commission went back

and showed how much underage a pipeline company has, at what price the gas is being purchased; that they're leaving this gas in the ground and taking gas elsewhere that is more costly; that the consumers are being hurt by this type of practice at this time. It may have some impact and it might cause the Federal authorities to direct a company to take less from one place. There may be some action taken to override some of the contracts that have take-or-pay clauses in them in preference and let gas from this source be taken in preference to this. I don't know that this would be done.

I'll say this; I think at this time with gas setting [sic] here that it certainly doesn't hurt to investigate possibilities.

Q. You're saying that the Commission can't do anything to alleviate this problem, but the Federal Government may? A. I think they might solicit the aid of the Federal Government to do it.

* * *

[98] *REDIRECT EXAMINATION* BY MR. BROCK:

Q. Mr. Wilkonson, I think in cross-examination on at least two occasions, I think maybe by Mr. Stucky and then by Mr. Byrd you got into the fact that the assigned deliverabilities have kind of come and gone between purchasers over the last number of years; I think Mr. Byrd went back to 1956. You are referring to a list, I assume, of those assigned deliverabilities, is that correct? A. Yes.

Q. Do you have a list of those deliverabilities and how they connected their deliverabilities — and the percentage of the field deliverabilities have varied from purchaser to purchaser throughout this field? A. Yes, sir. I have a list that covers from 1956 through 1981.

Q. And, would that list then indicate how various

pipelines [99] at various times have been underproduced and maybe worked out of their underproduction and maybe have gone back into underproduction? A. It would show by the percent of the pipelines — percent of pipelines [sic] total field deliverability by years; that they had a lot of production and then — In other words, this is not a production list; it's a percent of total field deliverability. It does show the change in the status from year-to-year.

* * *

Q. I hand you what the reporter has marked as Exhibit No. 13 and ask you to identify that. Is that the list of assigned deliverabilities? A. That's the distribution of total field deliverability by purchaser. It also shows the total number of wells [100] in the field on the right-hand column — at each year.

* * *

[101] Q. Well then, does this Exhibit 13 then demonstrate that the so-called underage problem is not anything particularly new to this field? A. No, I think it's cycles that we've been through, and it's corrected itself from time to time from one purchaser to another.

Q. And, do you have an opinion on whether if things are left alone at least in terms of not permanently cancelling underage, that this field again will work itself back into better balance? [102] A. I think it will.

MR. BROCK: I offer Exhibit No. 13 into evidence.

COMMISSIONER DICK: Are there any objections to Exhibit No. 13? It will be admitted.

KANSAS HUGOTON GAS FIELD
DISTRIBUTION OF TOTAL FIELD DELIVERABILITY

Year	Month	Total Field Deliverability (MCF)	Cities Service	Colorado Interstate	Mesa	Kansas Nebraska	Northern Natural	Panhandle Eastern	Total Field Wells
1956	December	4,937,353	32.42	7.71	8.68	7.06	25.20	14.85	3656
1957	December	5,029,147	31.45	7.33	7.86	6.84	26.84	15.78	3789
1958	December	4,885,352	38.91	7.16	7.47	6.54	28.37	15.56	3869
1959	December	4,853,118	30.04	6.35	6.93	6.41	31.16	15.29	3091
1960	December	4,868,110	28.37	7.04	7.54	7.26	29.28	16.13	3914
1961	December	4,912,024	27.39	6.96	7.41	7.11	27.28	18.55	3935
1962	December	5,689,149	40.29	6.90	6.18	6.06	21.70	17.97	3960
1963	December	8,490,814	47.29	5.46	5.10	4.50	23.81	13.17	3960
1964	December	9,114,490	44.77	5.18	6.23	4.21	22.28	16.70	3955
1965	December	8,684,572	41.24	6.05	6.79	4.70	22.98	17.64	3955
1966	December	8,266,112	40.57	6.63	6.74	5.87	22.25	17.29	3949
1967	December	7,885,492	40.10	6.52	6.73	7.35	21.90	16.60	3948
1968	December	7,504,895	39.29	7.13	6.74	7.87	21.90	16.33	3950

Exhibit 13
Admitted
Nov. 4, 1982

Year	Month	Total Field Deliverability (MCF)	Cities Service	Colorado Interstate	Mesa	Kansas Nebraska	Northern Natural	Panhandle Eastern	Total Field Wells
1969	December	6,913,537	36.43 (1)	7.22	7.05	6.82	22.84	16.78	3953
1970	December	6,797,585	32.43	6.79	11.85 (2)	6.07	23.96	16.66	3947
1971	December	6,303,499	28.83	7.09	10.96	6.99	26.34	17.70	3941
1972	December	5,573,536	25.58	7.76	9.48	9.07	27.00	18.93	3938
1973	December	5,118,325	24.68	7.65	8.25	11.05	26.85	19.41	3937
1974	December	4,610,170	26.58	7.76	6.25	11.28	27.38	18.28	3939
1975	December	4,120,057	29.66	8.18	5.59	9.99	27.17	16.81	3964
1976	December	3,766,051	33.26	7.96	5.41	9.37	26.51	15.02	3986
1977	December	3,581,346	34.40	7.46	5.30	7.62	26.31	16.79	4016
1978	December	3,374,296	33.04	7.20	5.66	5.78	27.77	19.57	4032
1979	December	2,932,685	31.25	7.17	6.38	5.38	28.82	18.80	4054
1980	December	2,542,602	33.54	7.33	6.76	5.62	27.97	16.61	4105
1981	December	2,292,236	37.00	9.11	5.59	6.30	26.65	13.30	4136

Notes: (1) Cities lost 171,981 MCF deliverability to El Paso.

(2) Mesa fractured and retested 69 wells in March, April and May.

[102] *RECROSS-EXAMINATION*

* * *

[106] BY MR. MARTIN [Counsel for Kansas-Nebraska Natural Gas Company]:

Q. Mr. Wilkonson, you were asked in the last cross-examination [107] by the staff if the basic proration formula encourages ratable taking, and you answered "yes". Would it be more correct or more accurate, in your opinion, to say that the basic proration formula or order encourages ratable taking over the life of the field? A. Well, I think it permits ratable taking over the life of the field.

Q. But, it's the addition of the phrase over the life of the field that I want to point out; that's really necessary to accurately describe what the basic manner or formula is designed to achieve, isn't it? A. Well, that's what it achieves.

Q. Yeah, what it does achieve and what it was designed to achieve. A. Yes.

Q. Now, if you impose at some stage a permanent cancellation of underages, you're really frustrating that objective, not enhancing the probability that it's going to be cheap? A. That's correct.

* * *

EXCERPTS FROM TESTIMONY OF S. JAVAID ANWAR

[108] *S. JAVAID ANWAR* [Witness for Cabot Petroleum Corporation], being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified on his oath as follows:

DIRECT EXAMINATION BY MR. BROCK [Counsel for Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum, Inc.]:

* * *

[109] COMMISSIONER DICK: Are there any objections to Exhibit No. 14? It will be admitted.

Is there any objection to Mr. Anwar's prefiled testimony being admitted into the record? It will be referred in.

(The prepared testimony of Mr. Javaid Anwar, follows:)

* * *

[111] Q. How many wells does Cabot Petroleum Corporation operate in the Kansas Hugoton Field? A. 38.

Q. Who is the purchaser of the gas from those wells? A. All of the wells are connected to [appellant] Cities Service Gas Company as purchaser.

Q. Have you made a study of those wells as to their cancelled underage, reinstated underage, and reinstated underage which has been produced? A. Yes.

Q. I hand you what the reporter has marked as Exhibit 14 and ask if that exhibit was prepared by you. A. Yes. It was prepared by me using data from the Monthly Hugoton Gas Reports published by this Commission.

Q. Please explain the exhibit. A. It shows the underage cancelled to the Cabot wells each month for the past

20 years, commencing January, 1962, through June, 1982, the total cancelled underage each year, and the total for the 20-year period, which is 3,172,365 Mcf.

The exhibit also shows the amount of cancelled underage which has been reinstated by order of the Commission and the month in which reinstated. The reinstated underage figures [112] have an asterisk in front of them. You will note that the first reinstatement occurred in February, 1973, and was in the amount of 138,198 Mcf. The reinstated underage figures each month thereafter, not marked by an asterisk, show the amount of such underage then remaining to be produced. Succeeding reinstated underage figures marked by an asterisk then set out the total of the previously reinstated underage not then produced, if any, plus the additional underage reinstated at that time. The total reinstated underage for each year shown at the bottom of the exhibit is the underage which was reinstated by Commission order during that year.

The exhibit also shows that during the 20-year period 1,158,808 Mcf of cancelled underage was reinstated, of which all but 153,298 Mcf was produced. In other words, 1,005,510 Mcf of reinstated underage was run. This also demonstrates that, with the possibility of minor or relatively insignificant exceptions, the wells are capable of producing their underage if given an opportunity.

Q. Has the accumulation of cancelled underage and the production of reinstated underage on the Cabot wells varied over the years? A. Yes. It has been cylical [sic]. The exhibit shows that essentially no underage was cancelled until 1967. Then, for the six-year period of 1967-1972, inclusive, 1,390,905 Mcf were cancelled. [113] During the next six-year period, from 1973-1978, inclusive, Cabot had 519,894, Mcf cancelled, but 1,158,808 Mcf were reinstated for a net reinstatement of 638,914

Mcf. As previously stated 1,005,510 Mcf of that reinstated underage has been produced. Then, during the last three and one-half years, from 1979-June, 1982, Cabot had suffered cancellation of 1,249,604 Mcf.

No doubt the cyclical changes are due primarily to changes in the marketing conditions of [appellant] Cities Service. Although [appellant] Cities projects continued reduced takes from the Hugoton Field for the next several years, no one can predict with complete accuracy what the market demands from the field may be several years from now.

Q. What effect did the reinstatement of cancelled underage during the six-year period beginning in 1973 have on the correlative rights of Cabot? A. It was necessary to protect those rights to permit Cabot to catch up to a considerable extent on the production of its fair share from the field.

As shown by my exhibit, Cabot had accumulated 1,978,703 Mcf of cancelled underage through 1979, but 1,158,808 Mcf, or approximately 59 percent, had been reinstated, and 1,005,510 Mcf, or approximately 51 percent of the total cancelled underage, had been reinstated and produced. Obviously, if Cabot had not been permitted to reinstate [114] this underage, it could not have been produced and Cabot could not have made up to this extent the deficiencies in the production of the allowables which were assigned to its wells.

Q. Have you read the prefiled testimony of Mr. Cook, the staff witness? A. Yes.

Q. What would have been the effect on the correlative rights of Cabot if the Commission had adopted Mr. Cook's recommendations prior to the makeup of the underproduction to which you have just testified, say in October, 1970? A. Cabot would have suffered a loss of correlative rights as it would have been denied the opportunity to produce some of the allowables assigned

to its wells and which, of course, were assigned on the basis of the fair share of gas for those wells. At the end of 1970, again referring to my exhibit, it shows that at the end of 1970 Cabot had 1,250,357 Mcf of underage cancelled. It continued to experience some cancellation of underage for the next two years. If Mr. Cook's proposals were in effect, which require reinstatement within two years, no doubt the overwhelming majority of the cancelled underage at the end of 1970 would have been permanently cancelled. Cabot, therefore, would have been denied the right to produce most of the reinstated underage which it did produce beginning in 1973.

* * *

[116] *CROSS-EXAMINATION* BY MR. BYRD [Counsel for Mesa Petroleum Company]:

Q. Mr. Anwar, on Page — the answer to Question No. 12 of your prepared testimony [page JA-118, *supra*] you say that you would have suffered a loss of correlative rights and would have been denied the opportunity to produce some of the allowables assigned to it if the staff's recommendations would have been in effect back when those underages accumulated, is that correct? A. Yes, sir.

Q. Would you agree with me that the opportunity to produce those allowables was permitted by the Commission's orders and assignments, was it not? A. Yes, sir.

Q. So, if you lost or if they were not produced, it was really [appellant] Cities Service's fault that they weren't produced? A. Well, I guess so, you're right.

Q. So, if you lost correlative rights, it was because your purchaser, [appellant] Cities Service Gas, didn't run them when [117] it was possible to run them? A. I guess so.

* * *

KANSAS HUGOTON
UNDERAGE CANCELLED - MCF
AS PER KANSAS CORP. COMM. MONTHLY ALLOWABLE SCHEDULES

		1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972
JAN.	- CANCELLED	–	(267)	–	–	–	(7822)	(3515)	(12512)	(7580)	(1988)	(9300)
	- REINSTATED											
FEB.	- CANCELLED	–	(1899)	–	–	–	(16267)	(269319)	(186455)	(112796)	(65955)	(5615)
	- REINSTATED											
MARCH	- CANCELLED	–	(171)	–	–	–	(674)	(20358)	(4452)	(3857)	(3569)	(2405)
	- REINSTATED											
APRIL	- CANCELLED	(4059)	(284)	–	–	–	(3113)	(41000)	(7199)	(7559)	(5430)	(5374)
	- REINSTATED											
MAY	- CANCELLED	(719)	(202)	–	–	–	–	(18647)	(3548)	(2236)	(1974)	(2321)
	- REINSTATED											
JUNE	- CANCELLED	(2899)	(444)	–	–	–	–	(7695)	(2710)	(3470)	(1395)	(2036)
	- REINSTATED											
JULY	- CANCELLED	–	(147)	–	–	–	(71922)	(29889)	(2286)	(2696)	(1241)	(2792)
	- REINSTATED											
AUG.	- CANCELLED	–	(491)	–	–	–	(1650)	(50165)	(3349)	(3055)	(1233)	(3225)
	- REINSTATED											
SEPT.	- CANCELLED	(29)	(68)	–	–	–	(734)	(49350)	(3264)	(3492)	(1353)	(3555)
	- REINSTATED											
OCT.	- CANCELLED	–	–	–	–	–	(870)	(89580)	(2284)	(3827)	(4970)	(3126)
	- REINSTATED											
NOV.	- CANCELLED	(38)	–	–	–	–	(2691)	(90604)	(2053)	(2427)	(7315)	(3502)
	- REINSTATED											
DEC.	- CANCELLED	(245)	–	–	–	–	(3788)	(70279)	(2994)	(2362)	(8224)	(4612)
	- REINSTATED											
TOTAL CANCELLED		(7989)	(3973)	–	–	–	(109531)	(740401)	(233106)	(155357)	(104647)	(47863)
TOTAL REINSTATED		–	–	–	–	–	–	–	–	–	–	–

Exhibit 14
Admitted November 4, 1982

KANSAS HUGOTON
UNDERAGE CANCELLED - MCF
AS PER KANSAS CORP. COMM. MONTHLY ALLOWABLE SCHEDULES

		1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	Total Period
JAN.	- CANCELLED	(5003)	(4914)	(8161)	(7164)	(3075)	(1501)	(4355)	(2917)	(18150)	(97873)	
	- REINSTATED	–	44032	151784	104957	66301	207004	285009	–	–	–	
FEB.	- CANCELLED	(9743)	(1263)	(39857)	(93438)	(3357)	(1522)	(2046)	(21840)	(22805)	(141896)	
	- REINSTATED	•138198	32826	149586	102862	63162	•469165	116263	–	–	–	
MARCH	- CANCELLED	(4793)	(1190)	(1260)	(6089)	(2595)	(1322)	(8735)	(2368)	(8617)	(24831)	
	- REINSTATED	136937	24202	•351856	100317	61717	445305	111500	–	–	–	
APRIL	- CANCELLED	(5478)	(3427)	(1510)	(8372)	(1472)	(1506)	(5370)	(1429)	(22990)	(88900)	
	- REINSTATED	135109	22532	325420	98743	–	429892	107493	–	–	–	
MAY	- CANCELLED	(5634)	(5504)	(1423)	(6339)	(2482)	(1972)	(4749)	(2746)	(26906)	(134539)	
	- REINSTATED	131367	13832	300119	97868	•236979	410941	103943	–	–	–	
JUNE	- CANCELLED	(5728)	(5918)	(1503)	(6087)	(4805)	(1526)	(4375)	(11030)	(30551)	(148949)	
	- REINSTATED	131352	7030	265433	93660	–	391071	100607	–	–	–	
JULY	- CANCELLED	(5105)	(4798)	(1442)	(4567)	(3279)	(1477)	(3975)	(10027)	(35078)		
	- REINSTATED	125139	2604	231600	88036	236979	197467	97110	–	–		
AUG.	- CANCELLED	(1112)	(5693)	(1518)	(4694)	(2546)	(1526)	(5023)	(10863)	(9419)		
	- REINSTATED	105740	–	195830	83589	235739	191580	93480	–	–		
SEPT.	- CANCELLED	(933)	(5990)	(1513)	(4955)	(2761)	(2719)	(5262)	(12372)	(55589)		
	- REINSTATED	87862	•197774	161722	76999	227369	185247	89905	–	–		
OCT.	- CANCELLED	(2577)	(5306)	(1467)	(5018)	(1473)	(2808)	(5577)	(16237)	(54233)		
	- REINSTATED	68938	187147	135817	71765	217624	•306673	–	–	–		
NOV.	- CANCELLED	(3530)	(2502)	(1518)	(4783)	(1516)	(2682)	(6127)	(8315)	(59247)		
	- REINSTATED	64778)	174039	116266	71765	217624	300663	–	–	–		
DEC.	- CANCELLED	(4098)	(5382)	(143595)	(3847)	(1477)	(2754)	(348)	(21296)	(91649)		
	- REINSTATED	56716	161595	106933	69478	211131	291180	–	–	–		
TOTAL CANCELLED		(53734)	(51887)	(204767)	(155353)	(30838)	(23315)	(55942)	(121440)	(435234)	(636988)	(3,172,365)
TOTAL REINSTATED		138198	197774	202270		236979	383587					(1,158,808)

Exhibit 14
Admitted November 4, 1982

[118] Q. And, would you agree that this Commission can't make a pipeline run gas? A. Yes, I agree with you.

Q. So, they don't violate your correlative rights, it's your purchaser? A. But, Commission can take the right that we can reinstate that gas over a period of time by putting a limitation of a two-year period, that we have to be overproduced by two months-two times the January allowable; maybe the condition might not improve, that we might not be in an overproduced status at that time, I mean two times the January allowable. Therefore, we have been denied the right to produce that cancelled gas that has accumulated over a period of time.

Q. But, even if the Commission reinstates it and eliminates [119] the two times overage, the purchaser didn't run the gas, your correlative rights are still going to be violated? A. That's correct, sir.

Q. So, it really gets down to the purchaser, doesn't it? A. Pretty much so, sir.

* * *

BY MS. GORHAM [Counsel for Commission Staff]:

Q. Are Cabot wells offset by other wells that are currently producing their allowables or in overproduced positions? A. Some of them, yes.

Q. Okay. How do the pressures of these Cabot wells compare to the pressures of those offsetting wells? A. On some of these wells, I have found difference of about 20 pounds.

Q. You feel that there is some compensated drainage occurring from the Cabot wells to these offsetting wells?

[120] MR. BROCK: Excuse me. Did you say compensating drainage?

MS. GORHAM: Drainage.

MR. BROCK: I'm sorry.

Q. There is drainage occurring? A. I haven't made

the study at this time, but given enough time, I have a feeling, yes, it's going to occur.

Q. You don't know if that's occurring at the present time? A. No, I haven't made a study of that.

Q. If there is drainage occurring, would Cabot's correlative rights be violated? A. Yes, Ma'am.

Q. In your opinion, is there any incentive in the existing policies existing in the basic proration order to provide incentives for purchasers to take the gas from this field? A. Well, I guess I should say the allowable is incentive, but if you want to call it — but there is nothing that stops the purchaser not to buy the gas.

Q. Is there anything that encourages the purchaser to take that gas? A. Well, the market demand should — really determines the incentive.

Q. Do you feel that the market demand is providing that incentive? [121] A. Not at the current time.

* * *

BY MR. DALE STUCKY [Counsel for Southwest Kansas Royalty Owners Association]:

* * *

[123] Q. Well, in any event, if you would have made — whether or not you could have, but if you would have made the same marketing arrangements in Hugoton as you are making more recently elsewhere, this problem would not have existed? A. You see this question really needs to be answered by the [appellant] Cities Services Gas Company, you know, which area that [124] don't take the gas and which area — I guess from [appellant] Cities Service it's more economical for them to not take gas from this Hugoton area and then probably rather pay take-or-pay — take a loss in that area.

Q. I understand, but would you answer my question, please? A. Would you repeat your question, please? I forgot it.

Q. Well, I said that you had made the same marketing arrangements in Hugoton as you have — the same arrangements that you have in these other areas, this problem that you pointed out in your exhibit would not exist? A. I'm not too sure if it would have existed or not; depends on the price of gas too. But, you see there's a different price gas; it's close to 50 cent gas, see, and that's $4.00 plus gas up there. So, we would have even — even have a take-or-pay contract, they might have still curtailed us here.

Q. Might have what? A. If we would have a take-or-pay contract in this area, they might have still curtailed us in this area if they didn't have a market to sell their gas.

Q. But, at least you'd get paid for it. A. Yes, sir.

Q. And presumably the landowners would get paid for their share. [125] A. Yes, sir.

EXCERPTS FROM TESTIMONY OF MICHAEL S. DAUGHERTY

[126] *MICHAEL S. DAUGHERTY* [Witness for Mesa Petroleum Company], being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified on his oath as follows:

DIRECT EXAMINATION BY MR. BYRD [Counsel for Mesa Petroleum Company]:

* * *

[128] COMMISSIONER DICK: Is there any objection to Mr. Daugherty's testimony being referred into the record?

MR. CARY [Counsel for Appelant]: Yes, Your Honor. Cities Service Gas Company would object to Questions and Answers 9 through 18, and move to strike such testimony on the basis that it is not relevant to this hearing. Wanting increased production, higher market demand and gas prices aren't at issue here.

* * *

[131] COMMISSIONER DICK: Mr. Byrd, do you have any comments?

MR. BYRD [Counsel for Mesa Petroleum Company]: Certainly.

Mr. Commissioner, I can appreciate those three pipeline purchasers not wanting a discussion of the price they're paying for gas in the Hugoton Field study in this proceeding. But, the purpose or the [132] merits of their objection, I think, evaporates when you read the testimony and understand that we're not asking this Commission to fix a price in the Hugoton Field. We're not asking them to do anything about the price. These answers go to explain how this witness feels it's important to the public that something be done about the takes in the Hugoton Field.

We appreciate that the staff's recommendations was [sic] to clear up some bookkeeping. Our recommendations are trying — they go to the increase in the takes and the runs from the Hugoton Field. We think that runs — increase in runs is the ultimate solution to the problems that we have. After Mr. Daugherty has explained, or after he has stated that he thinks it's important not only to the producers, but to the royalty owners, to the taxing entities in the State of Kansas, but also to the consumers, that runs be increased in the Hugoton Field by tightening these tolerance provisions that we're talking about. He explains why it's important to the consumers in Kansas that it's to their benefit to have these increased takes.

I think it all goes to the very issue that we're discussing here; that is the tolerance provisions and what effect do they have on runs from [133] the field. If that's not what we're talking about, I would be inclined to agree with Mr. Wilkonson; we're just talking about shuffling figures around, we can forget it. Cancelling underages or not cancelling doesn't increase the runs; I mean doesn't do anything to the pressure or to the field unless underages are run. We're talking about procedures here that are going to induce pipelines to buy more Kansas gas.

I'm surprised that Mr. Glaves would object to the reference to a exhibit that's already in the record before this Commission in another proceeding. That was really attached for the convenience of the parties that were in the other proceeding. All we have to do is ask the Commission take administrative notice of that document. But, we thought it would be more convenient if we attached it to Mr. Daugherty's testimony.

As to the record in the market demand proceeding, it will speak for itself, but I did participate in that proceeding, and there was reference made not only to direct

but on cross that one of the things that they take into consideration when they determine where they're going to buy gas is the tolerance provisions in field rules.

[134] I'll accept your challenge of the record on that, Mr. Glaves, because I asked the questions myself. It is in there.

We can hold our head in the sand here and talk about everything we want to, and we have up to now, I think, talked about everything. But, this gets to the guts of the issue. What are we going to do about runs? And, I think it's important that this Commission understand the effect that the increased runs or lack of increased runs are going to have not only on these pipeline purchasers but on the producers and on the royalty owners and on the taxing authorities of this state and on the consumers of this gas. If we're going to close the door to the effect it might have on consumers, I think we've disregarded a very important aspect of this problem.

I think this testimony is relevant. You're the ones who are going to have to decide whether or not you have any control or any avenue that can induce the purchasers to take more gas out of this field. That's going to be what really solves the underage; takes. I think this testimony is very relevant.

COMMISSIONER DICK: Pause for a moment while I read the questions that have been objected to.

[135] The Questions and Answers 9 through 16 will be referred into the record. Questions and Answers No. 17 and No. 18 will be struck from the record.

I believe there is adequate foundation for the questions that remain in. I think that clearly its [sic] been established that there could well be some relationship between the price, although the Commission does certainly have limited jurisdiction over the price. The price

in other fields could well have an impact on the amount of gas that is produced from the Hugoton Field.

* * *

[136] COMMISSIONER DICK: Are you offering Exhibits 15 and 16 at this time, Mr. Byrd?

MR. BYRD: Yes, I would.

COMMISSIONER DICK: I think the Commission could take administrative notice of Exhibit 16, but I think for purposes of clarity we'll go ahead and admit Exhibits 15 and 16.

* * *

(The prepared testimony of Mr. Daugherty, as amended, follows:)

* * *

[138] Q. What is the current status of Mesa and Tema wells? A. At the present time, the wells delivering gas to Kansas Power and Light are about 2.6 Bcf over-produced as shown on Exhibit 15. Based on the present market demand for the field, these wells could become in a serious overproduced situation in the near future if Mesa produces the requirements of KPL. On these wells, Mesa's concern is not so much with cancelled underages as it is with the possibility of over-production to meet the requirements of KPL. On the Tema wells, the purchasers are reducing their runs and the wells are under-produced.

Q. Having explained Mesa's interest and position in the field, what is Mesa's interest in this proceeding? A. Mesa is interested in increasing the production from the Hugoton Field, not only from Mesa's and Tema's wells, but from all wells in the field.

[139] Q. Why is Mesa concerned about increasing the production from all the wells in the field? A. Increased production from only Mesa's and Tema's wells

and not from the other wells in the field causes the pressures on our wells to decrease proportionately greater than the wells that do not increase their production. Under the present deliverability formula, this will ultimately reduce our deliverabilities and allowables. In other words, if production from the other wells does not increase, Mesa's and Tema's percent of the field allowables will decrease.

Q. Why does Mesa believe that production from the field should be increased? A. Mesa is aware of the recent reduction in the demand for natural gas industry-wide. It is our opinion that this reduced demand is due both to conservation efforts of the consumers, largely brought about by the increase in price, and the present business recession in the national economy. We are aware of the reduced markets of the interstate purchasers. However, the evidence presented by the purchasers and the Commission staff in the recent Market Demand hearings indicates that the Hugoton Field has suffered a proportionately greater reduction in the takes than the other fields from which the purchasers are buying gas. In Mesa's opinion this is not fair to the Hugoton producers, the royalty owners, the taxing entities within [140] the state or to Kansas consumers.

Q. Would you specify the evidence you are referring to that was presented in the Market Demand hearing? A. Yes, I refer to Staff Exhibit 15 which has been marked [Official] Exhibit 16. This exhibit shows that of the five (5) major purchasers in the Hugoton Field, all except one have reduced their Hugoton purchases much greater than their total system purchases.

Q. Do you have an opinion why this has happened? A. Yes, based on the explanations given by the purchasers in the Market Demand hearing, it is due to the existence of take or pay contract provisions in the purchasers' contracts in other fields and the more restric-

tive tolerance provisions in the basic proration orders of the other fields. In my opinion, this makes it easier to use Hugoton for storage than the other fields from which the purchasers buy gas.

Q. You stated that increasing production from the Hugoton Field would in your opinion be beneficial to the Hugoton producers, royalty owners, taxing authorities and to Kansas consumers. How would it be beneficial to Kansas consumers? A. Because, generally speaking, the Hugoton Field gas is the cheapest gas available to the purchasers. Any reduction [141] in the cost of gas due to increased runs from Hugoton is flowed through to the Kansas consumer.

Q. Could you cite an example? A. Yes. Mesa's intrastate purchaser, Kansas Power and Light Company, forecasts that approximately 37% (14 Bcf of 38 Bcf) of its main system gas for the winter period in 1982-83 will be obtained from Mesa out of the Hugoton and Council Grove Fields. This 14 Bcf of gas is presently priced at approximately 67¢ per Mcf. Low takes by other purchasers from the field and the resulting reduction in market demand from the Hugoton Field have necessitated KPL to seek additional short term supplies of gas. They have entered into a five (5) year contract with [appellant] Cities Service Gas for approximately 8 Bcf of gas per year. The November 1982 price of this gas will be in excess of $4.00 per Mcf. The difference between the price of this gas and Hugoton 67¢/Mcf gas from Mesa will be passed on to their Kansas customers.

Q. What will KPL's cost be for this gas? A. It appears that over the next five years KPL will purchase up to about 40 Bcf at over $4.00/Mcf at a total cost of about $160 million.

[142] Q. How much would that amount of gas cost KPL if it were purchased from Mesa at 67¢/Mcf? A. About $27 million.

* * *

[143] Q. Do you support the Staff's recommendation? A. Generally, yes. However, it appears Mr. Cook's primary concern is attempting to balance the field by limiting the reinstatement of cancelled underage. As I noted previously, Mesa wants to increase production from the Hugoton Field. It is my opinion that the Hugoton Field essentially is being used as a storage field. Mesa wants to end that practice.

* * *

[144] Q. What is your recommendation in this proceeding? A. It is Mesa's recommendation that the Commission adopt the Staff's proposals except that only one year instead of two years be granted to apply for reinstatement of cancelled underage for wells having underage cancelled after January 1, 1983, and that only one year instead of two years be allowed to make up the underages. Mesa also recommends that any reinstated underage not produced at the end of the one year period be cancelled permanently.

Q. Why do you want to shorten the time frames for reinstating and producing cancelled underages? A. In my opinion, shorter time periods will require the purchaser to take more gas by reducing flexibility and help eliminate the Hugoton Field being used as a storage reservoir.

* * *

**COMPARISON OF TOTAL PURCHASES
AND KANSAS HUGOTON PRODUCTION
FIVE MAJOR INTERSTATE PIPE LINE COMPANES
1977 thru 1981
ALL VOLUMES IN BCF**

Purchaser Year	(1) Total Gas Purchases	(2) % Chg. Over 5 yr.	(3) Hugoton Production	(4) % Chg. Over 5 yr.	(5) Percent (3) Hugoton to Total Purchase
Cities Service Gas					
1977	457.7		172.9		37.8
1978	462.5		173.7		37.6
1979	456.6		150.5		33.0
1980	414.1		110.5		26.7
1981	393.4	– 14.0%	102.3	– 40.8%	26.0
1982 (6 mo.)			37.6		
Colorado Inzerstate					
1977	395.2		44.4		11.2
1978	397.7		46.3		11.3
1979	426.3		37.8		8.9
1980	402.5		29.2		7.3
1981	340.7	– 13.8%	15.2	– 65.6%	4.5
1982 (6 mo.)			10.4		
Kansas-Nebraska					
1977	131.2		41.2		31.4
1978	137.5		45.9		33.4
1979	130.5		36.8		28.2
1980	120.9		33.6		27.8
1981	107.9	– 17.8%	24.1	– 22.4%	22.3
1982 (6 mo.)			12.9		
Northern Natural					
1977	759.7		130.4		17.2
1978	757.2		140.4		18.5
1979	801.0		135.7		16.9
1980	791.5		129.3		16.3
1981	826.8	+ 8.8%	114.3	– 12.3%	13.8
1982 (6 mo.)			45.5		
Panhandle Eastern					
1977	637.8		76.9		12.1
1978	691.4		104.6		15.1
1979	738.1		94.9		12.9
1980	742.0		80.8		10.9
1981	745.2	+ 16.8%	54.8	+ 10.3%	11.4
1982 (6 mo)			20.2		
Total Five Companies					
1977	2,381.6		465.8		19.6
1978	2,446.3		511.5		20.9
1979	2,552.5		455.6		17.8
1980	2,471.0		323.4		15.5
1981	2,414.0	+ 1.4%	340.7	– 26.9%	14.1
1982 (6 mo.)			131.4		

Exhibit 16
Admitted
Nov. 4, 1982

[145] *CROSS-EXAMINATION BY MR. DALE STUCKY* [Counsel for Southwest Kansas Royalty Owners Association]:

* * *

[148] Q. On Page 7 [page JA-131, *supra*], you point out that in your opinion "the Hugoton Field is essentially being used as a storage field." And you, commendably, I think, speak for your management and say that you want to end that practice. And on Page 8 [page JA-131, *supra*], you also point out that "the Hugoton Field is being used as a storage reservoir" in answer to Question 23. Would you please explain why you have that opinion? A. I think its been testified to in previous hearings that by purchasers, that they use it for swing production and for storage. It's my opinion that they do use it for storage and I don't know of anything that would make me think contrary to that.

Q. Well, what facts do you — Are you talking there about the record of, like [appellant] Cities, for example, producing some gas on five days a month? A. Yes, sir.

Q. Now, does Mesa engage in any storage? Do you have any storage fields? A. No, sir.

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[149] BY MR. JONES [Counsel for Mobile Oil Corporation, Northern Natural Gas Producing Company, Federal Land Banks of Wichita and Anadarko Production Company]:

* * *

[151] Q. Well, based upon your recommendation though, if the Commission adopted that recommendation, isn't under the current market status you're going to lose 26 billion, aren't you? A. I don't think so.

Q. Why not? A. In my opinion, cancelling underages does not necessarily constitute loss of reserves.

Now, as far as the [152] reservoir goes; the reservoir has no idea whether we're reinstating underage or whether we're producing cancelled underage or whether we're producing just underproduction that hasn't been cancelled. It ony responds to production.

Q. I understand. A. If we're allowed to produce our allowables, we can pull the pressures on our wells down, and we can cause compensating drainage to come back to us for any reserves that might have gone off our lease. Now, that's my opinion.

Q. And, that includes the 26 billion — the underage that you're talking about? A. Yes, sir.

Q. Over an extended period of time? A. It may take a while, yes, sir. We won't ever get it if they don't take the gas.

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[156] BY MR. YOUNG [Counsel for Amoco Production Company]:

Q. Mr. Daugherty, isn't your position that under your proposal and the proposal of the Commission staff, which I understand you are supporting, that this will result in incentives to the purchasers to take more gas from the Hugoton Field? A. I believe if I understand your question, that's — Our position is that this staff's proposal, as written in his prefiled testimony would provide an incentive for the purchasers to take gas in the Kansas Hugoton.

Q. What is the incentive? A. Tighter restrictions does not provide them a flexibility that they presently have.

Q. And, you believe that this will result in a taking of more gas? A. I do, yes, sir.

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[157] BY MR. McCARTHY [Counsel for Nothern Natural Gas Company]:

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[159] Q. And, under this formula, do you agree that the objection [sic] is to lower the pressure in the various wells in the field uniformly? A. That's the purpose of the formula, yes, sir.

Q. And, in general, has that formula been working? A. Yes, sir.

Q. But, there are variations or pressure differentials between wells now existing in that field, is that correct? A. Are now and probably always will be.

Q. And, to the extent that those pressure differentials continue to exist and perhaps become wider, you could have a situation where correlative rights could be effected [sic], could you not? A. Well, in my opinion, the correlative rights issue talks about ultimate depletion of the reservoir. Now — No, the formula does not force anybody to take gas. And, if to the ultimate depletion of the Hugoton Field, a purchaser doesn't take gas, correlative rights are going to be violated. The formula tries to keep it in balance so that everybody has the same opportunity. That's my understanding of it.

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[178] BY MR. BROCK [Counsel for Cabot Petroleum Corporation, Nothern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum, Inc.]:

Q. Mr. Daugherty, I'm not sure that I heard you correctly in response to an answer by Mr. Jones, but I thought that you said that the cancellation of underage would not have any effect on correlative rights or on the reserves that a well might produce. Was that your [179] answer to a question of his? A. Generally, that is my opinion, that it doesn't have — it doesn't have to have an effect on the reserves.

Q. Well, why is that that it does not have to have an effect? A. We — Well, if a well is underproduced for some period of time, its percentage of allowable is

greater than it would have been had that well produced its allowable.

Q. All right. So, in other words, because its pressure is relatively high due to the underproduction, it then is assigned a larger allowable, is that correct? A. That's correct.

Q. So, therefore, that larger allowable makes up for the difference of cancelling the underage, is that what you're saying? A. Not — not totally. But I am saying that the reservoir, and in my opinion, the reservoir — it really doesn't know if it's producing cancelled underage or producing allowable or producing underage that hasn't been cancelled. And as you produce that well — and that's the only way you can protect correlative rights is through production. As you produce this well and pull the pressure down, compensating drainage gas comes back to that lease.

[180] Q. Despite whether it makes up the cancelled underage or not, is that correct? A. If I produce my allowables.

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[194] BY MR. GLAVES [Counsel for Panhandle Eastern Pipeline Company]:

* * *

[200] Q. What you're saying, of course, is that the reason your percent participation is down is because of your higher rates of production as compared to the other purchasers in the field? A. Because we're producing our allowable, yes, sir.

Q. Which causes your pressures to go down, which in turn causes your allowables to go down and thus your percent participation? A. That's correct.

Q. And that simply is the deliverability formula working as it is designed to work, is that right? A. That's correct.

Q. And when your percent of participation goes down, it indicates that you have taken more than your fair share of the gas? [201] A. Oh, no, I didn't say that. We have taken our allowable and I stated that.

* * *

EXCERPTS FROM TESTIMONY OF JIMMY W. MOGG

[211] *JIMMY W. MOGG* [Witness for Panhandle Eastern Pipe Line Company], being first duly sworn to testify the truth, the whole truth and nothing but the truth, testified on his oath as follows:

[212] *DIRECT EXAMINATION* BY MR. GLAVES [counsel for Panhandle Eastern Pipe Line Company]:

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[213] COMMISSIONER DICK: Are there any objections to Mr. Mogg's testimony being referred at this time? It will be referred in.

(The prepared testimony of Mr. Mogg follows:)

* * *

[215] Q. What is the interest of Panhandle in the Hugoton Field? A. Panhandle purchases gas from 543 Hugoton wells for transmission in its interstate system.

Q. What is the position of Panhandle Eastern Pipe Line Company, as a purchaser in the field on the proposed amendment of Paragraph "p" of the Basic Order? A. There is sufficient underage and/or cancelled underage in Hugoton Field to cause concern as to whether correlative rights are being protected by the present reinstatement procedures. The tolerance provisions have been reached and cancelled underage is being incurred on many wells. It is apparent that the operators and purchasers need to be encouraged to bring this field into a more balanced state.

[216] Q. What are the tolerance provisions that you refer to? A. Paragraph "p" of the Basic Proration Order permits well operators to overproduce or underproduce assigned allowables by as much as six times the current allowable for the preceding January. So long as its production remains within this permitted tolerance, a well

will not be shut-in for overproduction or have any of its accumulated underage cancelled.

Q. Why are these tolerance provisions provided for in the Basic Order? A. According to the September, 1982 Kansas Hugoton Proration Schedule, there are 4,143 wells in the field, and the Commission recognized in the adoption of this provision of the Basic Order that it is physically impossible for the operators to check each well so closely as to take exactly the allowable in any one month. The field as a whole is never exactly in balance, and never will be, nor can it be expected to be. This fact has been recognized by the Commission and by the Courts through all of the litigation that has occurred over the operation of the deliverability formula.

Q. Why do these imbalances exist? A. In a common reservoir, gas flows from high to low pressure. It is also a fact that a well's pressure is directly responsive to its production rate. Divergent rates of take as a result of varying market conditions by the ten purchasers in the field has caused pressure differences to develop between the producing wells connected to different pipeline purchasers. Because of these inevitable pressure differences, an adjusting device was needed to insure the equitable assignment of periodic allowables, and in this field, that device has proved to be the adjusted deliverability formula found in Paragraph "k" of the Basic Proration Order.

* * *

[217] Q. Mr. Cook has noted that as of September 1, 1982, the current underage in the field was 204.5 Bcf. Isn't this indicative that the field is out of balance with the result that drainage as between leases is occurring and thus, correlative rights are being violated? A. First, it must be understood that some drainage is constantly taking place. The problem for the Commission as a prac-

tical matter is not to prevent the occurrance [sic] of drainage, but rather to see that such drainage is offset by counter-drainage and that ultimately there is not uncompensated drainage between developed leases.

Q. Does that satisfy the statutory requirements of K.S.A. 55-703? A. The lawyers tell me that it does. The only requirement of the statute, as I understand it, is that the production of gas must be in such portions as will currently permit the wells to produce without waste and to satisfy the market demands as will permit each developed lease to ultimately produce approximately the amount of gas underlying such developed lease, and currently produced proportionately with other developed leases in the same field, *without uncompensated cognizable drainage between separately owned developed leases or parts thereof.* So it is apparent that compensated drainage is permissible under the statute. It should be noted that the statute also provides that wells should be permitted to ultimately produce the reserves under the acreage attributed to their lease.

[218] Q. What should be the purpose of cancelling underage and of subsequently reinstating it, in your opinion? A. First, with respect to the cancellation of underage, I believe that it should be cancelled in such a manner as to provide an incentive for producing current allowables during the proration period in which they are assigned. Underage should be cancelled as a consequence of excessive underproduction. Such a cancellation of underage policy will encourage ratable taking. The timely production of current allowables is the essence of ratable taking. That is the goal that the Commission should seek to attain in both its cancellation of underage and its reinstatement of underage policies. Unless both policies work towards this single goal, there can be little hope of achieving ratable taking in this field.

Q. There have been suggestions in related proceedings that the objective of the Commission is to require the taking of gas from the Hugoton Field because it is cheap gas to consumers and of benefit to royalty owners and others with an economic interest in the Hugoton Field. Are those legitimate Commission objectives in your opinion? A. I won't debate the merit or demerit of these objectives, but I believe that conservation must be the compelling reason for action by the Commission in this area. In other words, it's the statutory requirement of ratable take, protection of correlative rights and the prevention of waste upon which the Commission's determination of these issues must be made.

Q. And is that the criteria upon which your recommendation is made in this proceeding? A. Yes, it is.

[219] Q. What does the phrase ratable taking mean to you? A. It is the production of allowables in a common source of supply in a timely manner. Failure to so produce is unratable taking and will result in drainage. The degree, of course, depends upon the extent which the allowable is not produced during the designated time period. If operators were permitted to ignore the allowables which the allocation formula assigns, there is no real proration in the field, and the rule of capture prevails. When such unratable taking is condoned, correlative rights are being violated.

Q. Why do you think that it is now advisable to strengthen the requirements for underage reinstatement? A. The existence of underage is certainly significant. Particularly, as the decline in the average wellhead shut-in pressure of the field approaches pipeline pressures, the making up of underage becomes more and more difficult, with the result that reserves that would otherwise be recoverable will be lost to the operator and correlative rights violated.

Q. If underage can't be produced why should the Commission be concerned? Won't the loss be sustained

by the party causing it? A. Only partially. Allowables are assigned to individual wells, not to operators or purchasers. Royalty owners are vitally affected by lack of ratable production and the resulting loss of recoverable reserves.

Q. Is there another factor which the Commission should consider in addressing the cancelled underage problem? A. Yes, that factor is the market demand. If the Commission continually sets the market demand above the nominations of the purchasers, the ability to reinstate and make up this cancelled underage within the new proposed regulation is not realistic, and such a policy will only frustrate resolution of the underage problem.

* * *

[225] Q. Would you please summarize the recommendations of Panhandle to the Commission in this matter? A. Yes. Panhandle is concerned with the amount of underage in Hugoton Field, Kansas and feels that the field should be brought closer into balance. It is also important that the Commission set the market demand relative to the purchaser's nominations in this effort to bring the field back into balance. Panhandle desires a workable solution to the underage problem and recommends that the following be adopted by the Commission in its consideration of changes to Paragraph "p" of the Basic Proration Order:

1. The effective date of the Order should be deferred to six months after the Order becomes finally effective, or in any event, not prior to July 1, 1983.

2. The time frame proposed by Staff should be extended for at least an additional one year, both as to reinstatement and make-up on the pre-1983 underage.

[226] 3. The 12 month extension period should be automatically effective so long as a well is in an over-

produced status. Administrative action should not be required.

4. Wells with cancelled underage should be able to be reinstated when they are overproduced as opposed to being two-times overproduced, as that may in fact result in an overproduced well.

5. Those wells with underage which are under Reinstatement Order should not be penalized, but should be afforded at least the same time to reinstate and make-up as those wells with underage that are not currently under Reinstatement Order.

6. Only wells that are physically incapable of producing 50 Mcfd should become "limited wells" as Staff proposes.

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[229] *CROSS EXAMINATION* BY MR. GREG STUCKY [Counsel for Southwest Kansas Royalty Owners Association]:

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Q. Now, referring to your answer to Question 16 which appears on Page 5 of your prefiled testimony [page JA-140, *supra*], in response to a question in which they ask whether the cancellation of underages and subsequent reinstatement thereof would — what purpose that would serve. Your reply is to provide an incentive for producing current allowables, is that not correct? A. Yes, sir, it is.

Q. Could you amplify that response and explain how, as I understand this would — why — why — why the cancellation of underages and the subsequent reinstatement thereof would provide an incentive for production of current allowables? [230] A. Okay. What I say there is that I believe it should be cancelled in such a manner as to provide an incentive for producing current allowables during the proration period.

Q. Okay. How would — What kind of manner would you suggest to the Commission to provide that kind of incentive? A. I don't know that I have anything that I could say exactly provides that incentive; whether it be staff's proposal or by modifications to it; if that will incur [sic] that more production will be run, that will be up to each pipeline to take a look at their reserves.

Q. I guess my question is why would you believe, and is it your testimony that through the adoption of either the staff's proposal or your proposal that adoption would provide an incentive for production of current allowables? I just don't understand why that adoption — new proposal would provide that kind of incentive. A. Well, what would happen if underages permanently cancelled, then the possibility of losing reserves would exist as well as the possibility of losing reserves the way the field is currently being produced exists. When you had to make a decision to cut back, then you would have to decide what's in [231] the best interest of your customers, your company. You'd have to take in all of your contracts, all of your prorated fields and study the entire problem.

Whether Mr. Cook's proposal or my modifications to it would be sufficient incentive to cause that, I can't answer that. I can't answer that for any other pipeline company.

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[237] BY MR. BYRD [Counsel for Mesa Petroleum Company]:

Q. Mr. Mogg, on answer to Question 15 [page JA-140, *supra*], you state that "The only requirement of the statute . . . is that the production of gas must be in such proportions as will currently permit the wells to produce without waste and to satisfy the market demands as well as permit each developed lease to ultimately produce approximately the amount of gas underlying such developed lease, and currently produced proportionately with other developed leases in the same field." Do you believe that the staff's recommendation would permit that? A. To produce without waste? Let me read it again. Sir, the question is one that I can't answer that. And the reason I say that is I do not know which wells [238] will incur permanently cancelled underage. But if in fact a well incurred permanently cancelled underage and it does not recover its reserves, then this would be violated.

Q. So, you're presuming that the well didn't produce it; won't have any underage if it produced? A. That's right. If it produces its allowable it will not have underage.

Q. Each well would be permitted to do these things, wouldn't it? A. Would be given that opportunity, yes, sir.

Q. And, as I interpret your answer there, that's all the statute requires? A. The opportunity, yes, sir. They can't require you to take gas.

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[239] Q. So, then you'd be in favor of tightening up the field rules? A. I think we're in favor of trying to keep our fields balanced; if tightening up the field rules — I'm not sure where you're leading. But you have to give them ample opportunity to take the gas. If tightening up the field rules after they've been given that opportunity brings the field more into balance, it's always been Panhandle's position that we like to keep our fields in balance.

Q. So then, if I understand your statement then, if — if the Commission would determine that tightening up the field rules might help keep the field in balance, you'd be for tightening up the field rules? A. Yes, sir.

EXCERPTS FROM TESTIMONY OF ROBERT McCLURE DANOS

[248] *ROBERT McCLURE DANOS* [Witness for Kansas-Nebraska Natural Gas Company], being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified on his oath as follows:

[249] *DIRECT EXAMINATION* BY MR. MARTIN [Counsel for Kansas-Nebraska Natural Gas Company]:

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[252] COMMISSIONER DICK: Are there any objections to Mr. Danos' prefiled testimony being admitted into the record at this time? It will be admitted.

(The prepared testimony of Mr. Danos, as amended, follows:)

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[254] Q. Please identify and explain Exhibit #18 (K-N #1). A. Exhibit #18 (K-N #1) is a two page exhibit. The first page is a graph showing gas requirements on Kansas-Nebraska's system over the last ten years, 1972 through 1981, and a projection of those requirements through 1985. Page 2 is the same information in tabular form.

Q. Exhibit #18 (K-N #1) indicates a decrease in requirements over the last ten years and especially since 1978. To what do you attribute that decline? A. Principally, the decrease is caused by fuel conversions by electric generating power plants and by gas conservation practices on the part of domestic and commercial customers. As you know, the national energy policies expressed in the Natural Gas Policy Act and the Fuel Use Act concentrated on achieving greater domestic energy fuels production and at the same time conservation of natural gas through policies that would encourage conversion to alternate fuels, predominately coal. The

impact of these national energy policies on Kansas-Nebraska has been to reduce our markets for gas in the geographical area we have historically served.

Q. Has Kansas-Nebraska been taking gas volumes from the Hugoton Field under a plan that takes into account the national energy policies and the impact of those policies on its service area? [255] A. Yes. Kansas-Nebraska has conducted its operations under a long-range plan which calls for conserving natural gas supplies for its customers in its traditional service area. An integral part of this plan is the program to take a portion of its supply each year from the Hugoton Field. The plan has been to take volumes from the Hugoton Field at a rate consistent with market needs which are seen as declining slightly over the next few years.

Q. Is Kansas-Nebraska able to accurately predict its market requirements? A. Even using the best methods to predict markets, it is still just an estimate and can be off in either direction. For this reason, flexibility must be built in to rules and regulations which govern the production of gas, just as we must have flexibility in the way in which we manage our supplies to meet our requirements.

Q. Would a change in the current rules affecting reinstatement of canceled underages impair flexibility? A. Yes, if canceled underages are no longer available for reinstatement, a large portion of this flexibility will be lost.

Q. Why specifically do you believe that canceled underages should be allowed to be reinstated? A. Historically since the mid-1960's, purchasers have been allowed to reinstate and produce previously canceled allowable underages. To change the scheme now would result in inequities to producers and mineral owners and to those pipelnes whose system requirements happen to be low at this point in time. In our case, as our system

requirements are increasing in the late 1960's and early 1970's, we were in an overproduced status and had no canceled underages. In order to meet the requirements of its customers, Kansas-Nebraska faced either curtailment of service or acquisition of additional sources of supply to meet those requirements. Kansas-Nebraska made new acquisitions and as those additional sources came on stream, our takes from Hugoton were decreased to reduce the then overproduced status, as well as to make room for the new gas. As a result of the reduced takes, our share of allowables were subsequently [256] significantly increased in the Hugoton Field. This, coupled with our new supply sources and a deteriorating market, has put us in our present underage position. In order for there to be no inequity to pipelines, producers, or royalty owners, and to preserve the vested property rights of each of these groups, there must be an opportunity to recover previously canceled underages as market conditions change.

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[257] Q. If the Staff's recommendation to permanently cancel all underages is adopted by the Commission, can Kansas-Nebraska take all volumes attributed to its underage and previously canceled underage during the time-frame recommended? A. No, if permanent cancellation is ordered, then even if Kansas-Nebraska maximized its takes from the Hugoton Field over that period of time, because of its contractual obligations to take from other sources and taking into account anticipated market requirements, we will be unable to take a volume of gas equal to current underages and previously canceled underages, as well as anticipated volumes attributable to current allowables through that period.

Q. Does that mean if the Staff's recommendations were adopted that such an order could deprive Kansas-

Nebraska of volumes of gas it has contracted to take? A. Actually, the volumes of gas will still be in the ground and still be available for production. However, an order adopting the Staff recommendations would deprive Kansas-Nebraska of the opportunity to take the gas as it has planned to take it over the next five to ten years. Under the Staff's proposal, Kansas-Nebraska and other pipelines would be able to take volumes attributed to underage and previously canceled underage through the next few years. At the end of that time Kansas-Nebraska and the other pipelines would be restricted to taking only current allowable and volumes attributable to underproduction to the extent permitted. Since the volumes attributable to the permanently canceled underage would not be available through the program of reinstatement, Kansas-Nebraska would have to wait until later in the productive life of the particular wells in order to take those volumes.

Q. What are the consequences to Kansas-Nebraska if the Staff's recommendation is adopted? [258] A. Kansas-Nebraska's customers, including approximately 46,700 domestic and commercial customers served directly and indirectly in We ern Kansas, have benefitted over the years from Kansa -Nebraska's comparatively lower system-wide cost of gas. If Kansas-Nebraska is deprived of the opportunity to continue taking volumes of Hugoton gas attributed to previously canceled underage after the next few years, then Kansas-Nebraska would in all probability have to supplement its total gas supply with new acquisitions which most likely will be more expensive, both in terms of gas cost and additional transmission cost, thus creating the likelihood of higher system-wide gas costs than would occur if the present reinstatement procedures were maintained.

Q. Has Kansas-Nebraska reviewed the Staff's recommendations to determine what they would accomplish?

A. As a result of our investigation of the Staff recommendations, we have concluded that, while there might be a small increment of additional production from the Hugoton Field over the near term, the long-term and net effect would be to deprive producers and pipelines of their lease and purchase contract property rights to produce the gas in a timely manner from the underlying acreage. Further, Kansas-Nebraska has been unable to discover any way in which the Staff recommendations would better serve either to protect the correlative rights of property owners in the Hugoton Field or to prevent drainage between offsetting wells. An action such as the Staff is recommending might generate more gas production during a short term period, but certainly conservation and protection of correlative rights are not served by the Staff's recommendation nor is the prevention of waste.

Q. In your opinion, does the Commission's present manner of treating canceled underage and the reinstatement of canceled underage under the basic proration order for the Kansas Hugoton Field serve to protect the correlative rights of landowners and producers? A. Yes, I believe it does. The manner in which the Commission now treats canceled underages and the reinstatement of those underages will protect the vested property rights of pipelines, producers and royalty owners by allowing production of approximately all recoverable volumes of gas underlying [259] each developed lease in the Field and permitting producers to produce their wells in such a way that developed leases are produced proportionately with the other developed leases in the Field.

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[261] *CROSS-EXAMINATION*

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[263] BY MR. BYRD [Counsel for Mesa Petroleum Company]:

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[264] Q. And I believe then in your answer to Question 25 [page JA-147, *supra*], you state that the staff's recommendations would reduce the flexibility — some of the flexibility you have in the Hugoton Field? A. That's correct.

Q. You again refer this, I believe, over in an answer to the Question 43 [page JA-148-49 *supra*]. There the question was, "Does that mean if the staff's recommendations were adopted that such an order could deprive Kansas-Nebraska of volumes of gas it has contracted to take?" And if I understand your answer is that it would not deprive you of those contracted volumes, it would just — it would require that you either take them quicker which you state you can't do or you'd have to wait until a longer period or the end of the field to get them? A. That is under the presumption as I have made that there would be no drainage.

Q. Yes. A. Yes, sir.

Q. So your well [sic] concern here is as a pipeline purchaser; is the flexibility that you feel Kansas-Nebraska requires? A. We do desire flexibility in the field and in all of our field takes, yes, sir.

* * *

[266] BY MS. GORHAM [Counsel for Commission Staff]:

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Q. [269] Q. Okay. Do you feel that under the present provisions of the basic order, there is incentive for producers and purchasers to run more gas from the Hogoton [sic] Field? A. I have a real probelm with that word incentive. I think of incentive as something that

is positive. I honestly don't mean to be cute, but I don't see anything positive that comes from the staff's proposal. Because, there is a danger of a violation of correlative rights and property rights. That's what we want to avoid.

Q. You don't feel there's a danger of violation of correlative rights under the existing provisions of the basis [sic] order, is that what you're saying? A. What I'm saying is I see no way in which the staff's recommendation would improve or have a better protection of property rights.

Q. You believe adequate incentive, and using it in the sense you have used it, exists in the existing language [270] in the basic order then? A. I think that we certainly have every incentive to take our gas that is contracted out of the Hugoton Field, yes, Ma'am.

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EXCERPTS FROM TESTIMONY OF DONALD A. HUTTON

DONALD A. HUTTON [Witness for Kansas-Nebraska Natural Gas Company], being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified on his oath as follows:

DIRECT EXAMINATION BY MR. MARTIN [Counsel for Kansas-Nebraska Natural Gas Company]

* * *

[273] COMMISIONER DICK: Is there any objection to Mr. Hutton's prefiled testimony being referred into the record at this time? It will be referred in.

* * *

(The prepared testimony of Mr. Donald A. Hutton, as amended, follows:)

* * *

[274] Q. Do you feel the current provisions of paragraph 'P' of the Kansas Hugoton Basic Proration Order pertaining to cancellation and reinstatement of allowable underages needs to be modified? [275] A. No, I do not.

Q. Would you please briefly explain your position. A. The Kansas Hugoton Field has a very long history of production, and has been governed by the basic proration order for nearly forty years. There have been circumstances which from time to time have required changes in the basic order. However, the correlative rights of the mineral interest owners and producers have always been protected by that order. Several companies have experienced conditions which required the accumulation of sizeable underages in the past to the point that those underages were cancelled and a large portion were subsequently reinstated and produced. Other pipeline companies are currently, or soon will be, in positions

where they, too, will have accumulated considerable underages, a portion of which will be, or have been, cancelled. To deny them the opportunity to make up those underages through the reinstatement process would prohibit them from producing the allowables attributable to the reserves under the acreage dedicated by contract to the pipeline. This in turn could impair the correlative rights of royalty owners and the producers. For this reason, I do not feel the current provisions of paragraph "P" should be changed.

* * *

Q. [282] Q. Mr. Hutton, have you testified on matters relating to accumulation and recovery of allowable underages before this Commission in prior hearings? A. Yes, I have. On October 23, 1975, I testified in Docket C-164 (M) in regard to Paragraph 'P' of the Basic Proration Order for the Kansas Hugoton Field. Again on March 23, 1978 I testified in response to a letter from the Commission dated January 18, 1978, which contained a twelve item data request. Two of those items dealt directly with underage status and makeup of such underages.

Q. What was the purpose of the October, 1975 hearing and what were the results? A. The hearing was held to review the language of Paragraph 'P'. On January 1, 1964 a moritorium [sic] on the cancellation of underages was ordered by the Commission and was in effect until January 1, 1967. At that time, the Order was amended to include cancellation of underages in excess of 20 times the January basic allowable. The tolerance limit on underage was further amended and reduced to 18 times and 15 times basic allowable for the period October 1, 1967 to December 31, 1967 and January 1, 1968 to November 30, 1975, respectively. Following the October, 1975 hearing the Commission issued an order which ter-

minated the moritorium [sic] and returned the tolerance to 6 times under-produced. The order also added specific provisions for reinstatement of cancelled underages to wells which became over-produced. The added provision starts with the last paragraph on page 17 of the Basic Order as Amended and reissued in May, 1978 [page JA-24, *supra*]. The provision added is as follows: "Provided also that underages cancelled under the provisions of this paragraph will be reinstated upon verified application therefore, showing that the wells are in an over-produced status; that the purchaser [283] is willing and able to take the amounts of gas; and that the length of time proposed by applicant for the production of the amounts of gas to be reinstated is reasonable under the circumstances."

Q. What was the general essence of the Commission's twelve point request in conjunction with the March 23, 1978 hearing? A. The Commission sought to review the general market requirements of the pipelines taking gas from the Kansas Hugoton Field and to review the factors then influencing the status of the field. Information furnished at the hearing indicated a general decline in the overall market requirements of the purchasers involved, although not to the extent now apparent.

Q. Does Kansas-Nebraska have plans to recover the underages attributed to Kansas Hugoton wells on its system? A. Yes, it does.

Q. How long will it take? A. That depends among other factors, upon the Kansas Hugoton Market Demand set by the Kansas Corporation Commission, the physical abilities of the wells to produce, the levels of takes from wells connected to other pipelines, and the market requirements for gas on Kansas-Nebraska's system.

Q. Would a change in the Basic Proration Order for the Kansas Hugoton Field, which put an end to the reinstatement of cancelled underages, such as the Staff

has proposed, reduce the amount of gas which Kansas-Nebraska could take from that field over the next few years? A. Yes.

Q. Please explain. A. As I mentioned before, Kansas-Nebraska has been in a makeup posture since 1978. We have taken gas at rates greater than the allowables assigned to the wells connected to our system. This is and has been planned. However, by taking in this manner we have caused a continued decline of the wells' shut in pressures which has resulted in assignment of smaller allowables to those wells. This [284] is the pattern the Adjusted Deliverability Formula is designed to yield. If these wells are not allowed to receive reinstatement of previously cancelled underages they will exceed the tolerances of the field rules and attain a shut in status.

Q. Can you give us an example on an individual well basis of how a modification of the current rule relating to reinstatement of underages might prohibit that well from producing its proportionate share of the current production realized by those wells connected to Kansas-Nebraska's system? A. Yes, let's use as an example the CSC-Hicks #1 located in Section 28-24S-36W, Kearny County, Kansas. This is a well which is and has been receiving a minimum allowable because it did not have a shut in pressure equal to or greater than the Deliverability Standard Pressure (DSP) on its previous test, April 24, 1980. For that test, its shut in pressure was recorded as 126.7 psig and the 1980 DSP was 127.8 psig. The reason this low pressure was recorded is, in part, because the well was produced for a period at rates higher than its historical share of total field production in order to makeup underage allowable it had accumulated earlier. The well had previously experienced cancellation of underages, the last cancellation occurring in March, 1979.

In the winter of 1980-81, the well had a status of 0.1 times basic under-produced. It had a producing capability of about 1,500 Mcf/day and was being assigned an allowable of 50 Mcf/day at that time. During the months of December, 1980 and January, 1981, it produced 42,092 Mcf compared to its allowable of 3,100 Mcf for those two months. So it produced 38,992 Mcf in excess of its current allowable assigned for the two months. By the end of January, 1981, with the new basic allowable that became effective February 1, 1981, the well had produced such that it was 33.7 times basic over-produced. A well so over-produced is required to be shut in. Of course, this prevents it from being able to produce its proportionate share of the Kansas-Nebraska system demand for February and March, which would have been an approximate volume of 35 MMcf. However, at the end of January the well had a cancelled underage balance of 660,798 Mcf. By reinstating the previcusly cancelled underage, the well would be allowed to produce the 35 MMcf and meet its proportionate share of the Kansas-Nebraska system demand for February and March.

[285] Due to the current provisions of Paragraph "P" of the Basic Order, this well did have the opportunity to produce those volumes. If the reinstatement provisions were not available, the well could not have produced its proportionate share of the market.

I believe the foregoing example illustrates how the denial of the opportunity to reinstate previously cancelled underage will, in the short run and on a current basis, create a situation where a well would not be allowed to produce its proportionate share of market requirements.

* * *

APPELLANT'S BRIEF

No. 86-1856

Supreme Court, U.S.
FILED
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

NORTHWEST CENTRAL PIPELINE CORPORATION,
Appellant,

vs.

STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, *et al.*,
Appellees.

On Appeal After Remand To The Supreme Court of Kansas

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QUESTIONS PRESENTED

1. Whether the ruling of the Kansas Corporation Commission, that is designed (i) to cause interstate pipelines to purchase more natural gas from Kansas and less natural gas from other states, and (ii) to cause gas dedicated to interstate commerce to be diverted to Kansas markets, violates the exclusive authority of the Federal Energy Regulatory Commission (i) to regulate the cost structures of interstate gas pipelines, and (ii) to control and regulate abandonments of natural gas dedicated to interstate commerce, in violation of the Supremacy Clause of the United States Constitution.

2. Whether the ruling of the Kansas Corporation Commission, that is designed to cause large volumes of natural gas previously dedicated to interstate commerce to be diverted by force of Kansas law to the Kansas intrastate market, constitutes impermissible state regulation of interstate commerce in violation of the Supremacy and Commerce Clauses of the United States Constitution.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Northern Natural Gas Company, Amoco Production Company, Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation, Kansas Petroleum Inc., Colorado Interstate Gas Company and KN Energy, Inc. have been appellants together with Northwest Central Pipeline Corporation before the Supreme Court of Kansas. Michael Lennen, Chairman, Richard D. (Pete) Loux, Commissioner, and Phillip R. Dick, Commissioner, and their respective successors, of the State Corporation Commission of the State of Kansas, have appeared in opposition to Northwest Central Pipeline Corporation before the Supreme Court of Kansas.

The following companies also appeared before the State Corporation Commission of the State of Kansas at the initial proceeding:

Southwest Kansas Royalty Owners Association
Mobil Oil Corporation
Northern Natural Gas Producing Company
Federal Land Bank of Wichita
Anadarko Production Company
El Paso Natural Gas Company
Mesa Petroleum Company
Kansas Power and Light Company
Panhandle Eastern Pipeline Company
Kansas-Nebraska Natural Gas Company
Arco Oil and Gas Company
Cities Service Company
Affiliates of Northwest Central Pipeline Corporation (now known as Williams Natural Gas Company) are listed in Appendix J to the Jurisdiction Statement.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

No. 86-1856

NORTHWEST CENTRAL PIPELINE CORPORATION,
Appellant.

v.

THE STATE CORPORATION COMMISSION OF
THE STATE OF KANSAS, *Et Al.*,
Appellees.

**On Appeal After
Remand To The
Supreme Court Of Kansas**

BRIEF FOR THE APPELLANT

STATEMENT OF JURISDICTION

In this case, Northwest Central Pipeline Corporation (Northwest Central)[1] appeals a judgment of the Kansas Supreme Court entered on February 20, 1987. That judgment upheld an order of the State Corpo-

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[1] Effective January 1, 1987, Northwest Central Pipeline Corporation changed its name to Williams Natural Gas Company. In order to prevent confusion, however, the name Northwest Central is used throughout this brief.

ration Commission of the State of Kansas (KCC) which amended paragraph (p) of the KCC's Basic Proration Order for the Kansas-Hugoton Field. On March 25, 1987, Northwest Central submitted a notice of appeal of the Kansas Supreme Court's decision. On May 23, 1988, the Supreme Court granted review of that appeal. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2). *Atchison, Topeka & Santa Fe Ry. v. Public Util. Comm'n*, 346 U.S. 346, 348 (1953).

OPINIONS BELOW

The Opinion of the Kansas Supreme Court dated February 20, 1987 (JS App. at 1a-12a), [2] is reported at 240 Kan. 638, 732 P.2d 775. The opinion of the Kansas Supreme Court dated May 10, 1985 (JS App. at 13a-52a), is reported at 237 Kan. 248, 699 P.2d 1002. The opinion of the District Court of Gray County, Kansas issued November 7, 1983 (JS App. at 53a-62a) is not reported. The orders of the Kansas Corporation Commission dated February 16, 1983 (JS App. at 63a-80a), and April 18, 1983 (JS App. at 81a-92a), are not reported.

FEDERAL CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The applicable Federal Constitutional provisions are reproduced at page 98a of JS App. H. The applicable state statutes and regulations are reproduced at pages 105a-125a of JS App. I. Section 1(b) of the Natural Gas Act (NGA), 15 U.S.C. § 717(b), and Sections 601

[2] References herein to "JS App." are to the Appendix filed with the Jurisdictional Statement. References to "J.A." are to the Joint Appendix filed with this brief.

and 602 of the Natural Gas Policy Act (NGPA) are reproduced at pages 98a-104a of JS App. H. Finally, Sections 4, 5, and 7 of the NGA, 15 U.S.C. §§ 717c, d, and f, are attached to this brief.

STATEMENT OF THE CASE

This case, like this Court's decisions in *Northern* and *Transco*, involves the constitutionality of a state agency order which purports to regulate the correlative rights of gas producers, but which conflicts with the regulatory provisions of the Natural Gas Act (NGA), 15 U.S.C. § 717 *et seq. See Northern Natural Gas Co. v. State Corp. Comm'n of Kan.*, 372 U.S. 84 (1963) and *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Bd.*, 474 U.S. 409 (1986). As in those cases, the Order is being challenged on grounds that it violates the Supremacy and Commerce Clauses of the United States Constitution. JS App. H.

The order in question was issued February 16, 1983 by the KCC as an amendment to paragraph (p) of its Basic Proration Order concerning the Kansas Hugoton Field. JS App. at 63a-80a. Its unmistakable purpose, as admitted by the KCC's sponsoring staff witness, was to force interstate natural gas pipelines to purchase a greater share of their total gas supply mix under contract in the Kansas Hugoton Field at the expense of their contracted supplies located in other producing states. *See, e.g.*, J.A. at 49, 50. Unless this is done, the Order would cause these pipelines to lose forever gas supplies that have been dedicated to them by contract without the receipt of any abandonment authority from the Federal Energy Regulatory Commission (FERC) under the NGA. *See* p. 12 *infra*.

Northwest Central has long been a major purchaser of natural gas under long term contracts with producers in the Kansas-Hugoton Field. It owns and operates an extensive interstate gas pipeline system for the purpose of transporting and selling gas to customers in Kansas, Missouri, Oklahoma, Texas, Nebraska and Colorado. It purchases gas from producers in Texas, Oklahoma, Kansas, Wyoming and Colorado and from three interstate natural gas pipelines. As an interstate gas pipeline, Northwest Central is subject to the jurisdiction of the FERC under the NGA, 15 U.S.C. §717 *et seq.*, and NGPA, 15 U.S.C. § 3301 *et seq.*

The producers who have contracted to sell gas to Northwest Central and other interstate pipelines from the Kansas Hugoton Field are also subject to the jurisdiction of the FERC under the NGA. As described *infra*, most of this gas is produced from older wells and was not deregulated under the NGPA.

A. Federal Statutory and Regulatory Background

1. "The NGA long has been recognized as a 'comprehensive scheme of federal regulation. . . . .' " *Schneidewind v. ANR Pipeline Co.* (*Schneidewind*), 108 S.Ct. 1145, 1151 (1988), *quoting Northern*, 372 U.S. at 91. "The NGA confers upon FERC exclusive jurisdiction over the transportation and sale of natural gas in interstate commerce for resale." *Schneidewind*, 108 S.Ct. at 1151.[3] Under NGA Sec-

[3] NGA § 1(b) gives the FERC jurisdiction over (1) the transportation of natural gas in interstate commerce, (2) the sale of natural gas for resale in interstate commerce and (3) natural gas companies engaged in such sales or transportation. Each of these grants is an independent, albeit overlapping, fountain of

tions 4 and 5, 15 U.S.C. §§ 717c and d, the FERC regulates the rates charged by natural gas companies for interstate transportation and the sale for resale of natural gas.[4] Through the exercise of its authority under these NGA sections and Section 601 of the NGPA, 15 U.S.C. § 3431, the FERC regulates the mix of purchases by natural gas pipelines. *Northern*, 372 U.S. at 92; *Office of Consumers' Counsel v. FERC*, 783 F.2d 206, 233 (D.C. Cir. 1986). The issue of whether Northwest Central should increase its purchases from the Hugoton Field is currently before the FERC.[5]

Under NGA Section 7(c), "a natural gas company must obtain from FERC a 'certificate of public convenience and necessity' before it constructs, extends, acquires or operates any facility for the transportation

authority. *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972). Section 1(b) exempts "production or gathering" from the jurisdiction of the FERC. This exemption, however, has been " 'narrowly confined to the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution.' " *Transco*, 474 U.S. at 418, *quoting Northern*, 372 U.S. at 90.

[4] In *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), this Court held that gas producers who sold their gas in interstate commerce were natural gas companies within the meaning of the NGA and were subject to the NGA's certificate, abandonment, ratemaking and reporting requirements. Prior to *Phillips*, only interstate natural gas pipelines were deemed to be natural gas companies.

[5] *Northwest Central Pipeline Corp.*, 33 FERC (CCH) ¶ 63,067, p. 65,275 (1985). In *Northwest Central*, after extensive hearings, a FERC Administrative Law Judge found that Northwest Central's purchasing mix was prudent and did not violate NGA Sections 4 and 5. 33 FERC (CCH) at 65,278. The Law Judge's decision is currently pending at FERC.

or sale of natural gas in interstate commerce." *Schneidewind*, 108 S.Ct. at 1152. Before issuing a certificate for the construction of a major gas transportation project, the FERC and its predecessor, the Federal Power Commission (FPC),[6] historically considered whether gas reserves are sufficient to support the project. *See, e.g., Cities Service Gas Co.*, 2 FERC (CCH) ¶ 61,268, p. 61,595 (1978); *Cities Service Gas Co.*, 38 FPC 364, 370-71 (1967). Indeed, applicants for certificates are required by the FERC's rules to submit detailed information regarding the gas supplies underlying the proposed project. 18 C.F.R. § 157.14(a)(10).

In order to protect the natural gas reserves dedicated to interstate commerce on or before November 8, 1978, NGA Section 7(b) places limits on the abandonment of services provided to natural gas pipelines.[7] Section 7(b) bars such abandonment "without FERC approval, including a finding by FERC that either the available gas supply is depleted, or 'the present or future public convenience or necessity per-

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[6] On October 1, 1977, the Federal Power Commission ceased to exist and its functions were transferred to the FERC and the Secretary of Energy pursuant to provisions of the Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 565 (1987) and Executive Order No. 12009, 42 Fed. Reg. 46267 (1977).

[7] NGA Section 7(b) is applicable to most natural gas that was dedicated to interstate commerce prior to the enactment of the NGPA. NGPA Section 601(a)(1)(B), 15 U.S.C. § 3431(a)(1)(B), however, removed NGA jurisdiction with regard to certain categories of natural gas that were committed or dedicated to interstate commerce as of November 8, 1978. As described *infra*, however, the vast majority of the Kansas Hugoton gas remains subject to the requirements of NGA Section 7(b).

mit such abandonment.' " *Schneidewind*, 108 S.Ct. at 1152-53. Section 7(b), thus, prevents the abandonment or loss of natural gas previously dedicated to interstate commerce or the diversion of such gas to intrastate markets without FERC's approval. *See, e.g., United Gas Pipeline Co. v. McCombs*, 442 U.S. 529, 543 (1979); *California v. Southland Royalty Co.*, 436 U.S. 519, 522-23 (1978).

2. Because of "serious gas shortages" in the 1970's which were largely driven by the "[t]he NGA's 'artificial pricing scheme,' " Congress enacted the NGPA in 1978. *Transco*, 474 U.S. at 420. The NGPA represented a careful and comprehensive legislative compromise which provided incentive prices for certain new gas while at the same time protecting consumer access to low-cost old gas. *See, e.g., FERC v. Martin Exploration Management Co.*, 56 U.S.L.W. 4458 (U.S. May 31, 1988) (Nos. 87-363, *et al.*); *Public Service Comm'n of N.Y. v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 331-335 (1983); 124 Cong. Rec. 28,633 (1978) (remarks of Sen. Jackson); 124 Cong. Rec. 38,361-67 (remarks of Rep. Dingell).

While the NGPA made significant changes in FERC's statutory responsibilities over natural gas production, the NGPA does not affect the applicability of the NGA to this case. The Kansas-Hugoton gas consists primarily of "old gas" subject to the price ceilings set forth in Sections 104 and 106(a) of the NGPA 15 U.S.C. §§ 3314, 3316(a), which was committed or dedicated to interstate commerce on or before November 8, 1978. The NGPA left intact NGA regulation with regard to this old gas. NGPA Section 601(a)(1)(B), 15 U.S.C. § 3431(a)(1)(B). *See also, Public Service Comm. v. Mid-Louisiana Gas Co.*, 463 U.S.

at 334; *United Gas Pipeline Co. v. McCombs*, 442 U.S. at 536 n. 9; *Consolidated Edison Co. of N. Y. v. FERC*, 823 F.2d 630, 633 (D.C. Cir. 1987).

B. The History Of The KCC's Proration Rules And The Amendment Before This Court

1. The Hugoton Gas Field is considered to be one of the largest known reservoirs of natural gas in the world. JS App. at 55a. About two-thirds of the Field is located in Kansas. The great majority of the Kansas-Hugoton gas is dedicated by contract to five interstate natural gas pipelines including Northwest Central who serve markets in other states.[8] J.A. at 114.

Much of the remaining gas supply is committed to the Kansas intrastate market. Mesa Petroleum Corporation, for example, is a major intrastate supplier in the Kansas-Hugoton field. *See* JS App. at 50a; Exhibit 9.[9] Much of its acreage adjoins the producing acreage dedicated to Northwest Central. *See* Exhibit 9.

2. Like other gas producing states, Kansas has enacted statutes designed to prevent waste and to protect the correlative rights[10] of all producers taking gas from a common source of supply. Kan. Stat. Ann. § 55-601, *et seq.*, JS App. at 105a-113a. Section 55-

[8] The other four interstate pipelines are: (1) Colorado Interstate Gas Company; (2) Northern Natural Gas Company; (3) Panhandle Eastern Pipe Line Company; and (4) KN Energy, Inc.

[9] Exhibit 9 is a color-coded map of the producing acreage in the Kansas-Hugoton Field. Because of its large size, copies of this map were filed with the Court separately from the Joint Appendix.

[10] The interests of owners of natural gas wells in a common pool whose wells are being drained through the overproduction of a well operated by another producer are typically referred to as "correlative rights." *Transco*, 474 U.S. at 412.

703 provides that the KCC "shall regulate the taking of natural gas from any and all common sources of supply within this state in order to prevent the inequitable or unfair taking of natural gas from a common source by any person, firm or corporation . . . in favor of or against any producer in any common source of supply." JS App. at 112a.

Pursuant to this statute, the KCC issued the Basic Proration Order for the Kansas Hugoton Gas Field on March 21, 1944. This Order provides limits, or "allowables," for production for each well located in the Kansas Hugoton Gas Field. Producers that fail to produce their allowables accrue "underages" equal to the difference between their allowables and actual production. JS App. at 4c. Since 1956, the practice of the KCC has been to fix production allowables far in excess of the overall demand for gas from the Hugoton Field as reflected in the nominations submitted by purchasers.[11] *See* JS App. at 45a; J.A. 120. Consequently, interstate pipelines accumulated huge underages. J.A. at 120-21.

Under the 1944 Order, once the cumulative underages reached certain levels, underages were cancelled.

[11] The KCC has established allowables far in excess of market demand, notwithstanding Kan. Stat. Ann. § 55-703 which provides that in establishing the market demand to be used in fixing allowables, the KCC is enjoined to "consider the reasonable current requirements for current consumption and use within and without the state, and such other factors, conditions, or circumstances that would aid in establishing the market demand." JS App. at 111a-113a.

However, the KCC routinely allowed cancelled underages to be reinstated upon application of the producer without restriction as to time.[12] *See* J.A. at 147. Producers, thus, were able to recoup large amounts of underages during the gas shortage period of the 1970's when they experienced high demands for the Kansas-Hugoton gas. *See, e.g.*, JS App. at 19a; J.A. at 120-21. Beginning in the latter 1970's, underages for interstate pipelines began growing again. *See* JS App. at 19a; J.A. at 121.

3. In view of the increased underages, the KCC initiated hearing procedures to determine whether paragraph (p) of its 1944 Basic Proration Order should be modified. J.A. at 29-31. Subsequent to the hearing, the KCC issued an order on February 16, 1983 amending paragraph (p). The KCC there adopted its own Staff witness' proposal which provided for *permanent* cancellation of the underages unless the underage is reinstated and produced within fairly short

---

[12] Paragraph (p) of the 1944 Basic Proration order specifically provided, until the KCC's action at issue here, that (1) any well must be "shut-in" (and production thus curtailed) if the well has overproduced its allowable by a cumulative amount equal to six times its allowable for the month of January; (2) if any well fell short of producing its allowable by a cumulative amount equal to six times the prior January allowable, this shortfall would be cancelled and the producer required to apply to the Commission to reinstate the cancelled underage before later making up the shortage; and (3) cancelled underages will be reinstated upon a "showing that the wells are in an over-produced status; that the purchaser is willing and able to take the amounts of gas; and that the length of time proposed by applicant for the production of the amounts of gas to be reinstated is reasonable under the circumstances." There was no permanent cancellation of these allowables. *See* JS App. at 68a.

time periods.[13] Thus, for the first time, approximately forty years after the original Proration Order, the KCC placed time limits on the reinstatement of underages and provided for the permanent cancellation of such underages. Because of its adoption of the Staff proposal, the KCC rejected an alternative request that it cure the production imbalances and protect correlative rights by reducing general production allowables to a rate consistent with overall market demand. JS App. at 75a; J.A. at 76.

In explaining the amendment to paragraph (p), the KCC Staff witness stated repeatedly that the intent of this amendment was to induce interstate natural gas pipelines to change their purchase mix so as to purchase more natural gas from Kansas Hugoton.[14] He also acknowledged that the effect of his proposal could be quite expensive to interstate natural gas

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[13] The amendment specifically provides that: (1) underages cancelled before 1975 could be reinstated only if reinstatement had been requested by the end of 1983; (2) underages cancelled from January 1, 1975, through December 31, 1982, could only be reinstated if reinstatement was requested by December 31, 1985, and only if the well was in an overproduced status at the time of the request; and (3) underages cancelled after December 31, 1982 could only reinstated within three years of the cancellation and only if the well was in an overproduced status at the time of the request. JS App. at 68a-69a.

[14] J.A. at 50 (emphasis added), from cross-examination of the KCC Staff witness:

> Q. But what you simply are doing is trying to provide some incentive that the *purchasers* will take this underage, given the limited market?
>
> A. "That's correct."

See also J.A. at 36, 49.

pipelines and their customers (J.A. at 54-55) and that he did not know if his proposal would actually have its intended effect (J.A. at 49).

4. The KCC also amended paragraph (p) with full knowledge that its action would lead to the permanent loss of natural gas reserves dedicated to interstate commerce and the diversion of such interstate reserves to intrastate markets. This loss and diversion of dedicated reserves occurs because the reserves associated with the underproduced wells dedicated to interstate markets will migrate to the nearby overproduced wells, such as the adjoining wells of Mesa that are dedicated to the intrastate market.[15] *See, e.g., Transco*, 474 U.S. at 411-12 ("[a] recognized property of a common pool is that . . . gas flows towards the area of the producing well"). The KCC's permanent cancellation of underages will prevent that migration from later being offset by the compensating cross migration of reserves back to the affected well, thus resulting in the permanent loss of those dedicated reserves. *See* JS App. at 50a (Schroeder, C.J. dissenting) ("the result of cancellation under this order will be to .... no longer permit the corrective or

[15] J.A. at 88-92. The record shows that: (1) the overproduced intrastate wells owned by Mesa are surrounded by underproduced wells dedicated to interstate commerce (Exh. 9; J.A. 89-90); and (2) the intrastate wells which are owned by Mesa experienced pressures substantially below the pressures of wells dedicated to Northwest Central's predecessor in name, Cities Service (J.A. 90; J.A. 96). Thus, while the question of whether this loss of reserves will occur with respect to any single well would require a detailed factual analysis of the circumstances of that and surrounding wells, the record shows that some loss or diversion of reserves dedicated to interstate commerce is inevitable.

compensatory drainage which was the hallmark of the prior commission order for years." *See also*, J.A. at 91.[16]

C. The Orders Of The Courts' Below

1. Four interstate natural gas pipelines, including Northwest Central, and one natural gas producer sought review of the KCC's revision to paragraph (p) in the District Court of Gray County, Kansas. On November 7, 1983, the district court issued an order affirming the KCC, finding that "[s]ince this K.C.C. Order deals with the producers of natural gas it falls within the specific exemption of the Federal Natural Gas Act . . . allow[ing] the State to regulate the 'production or gathering' of natural gas." JS App. at 59a. The district court reached this conclusion even though it also found that "as a practical matter, the change in 'P' will cause some permanent loss of underages (allowables) due to market conditions and *will also cause a change in the 'mix' of natural gas which pipelines transport for sale many miles away*." JS App. at 58a (emphasis added).

2. On May 10, 1985, the Kansas Supreme Court issued its first opinion (*Kansas I*) affirming the judgment of the Kansas District Court, with Chief Justice Schroeder dissenting. JS App. at 13a. However, it expressed serious reservations as to whether the amendment to paragraph (p) will effectuate the pur-

[16] The KCC has issued temporary moratorium orders concerning the effectiveness of the amended paragraph (p) making it unnecessary for Northwest Central and other pipelines to seek a judicial stay of the order pending judicial review. *See, e.g.*, Amoco Prod. Co., Docket Nos. C-164, *et al.* (KCC Sept. 16, 1987).

pose of the rule, *i.e.* to stimulate production, finding testimony to be "quite persuasive that the amendment would not have the desired effect of increasing production. . . ." JS App. at 37a.

The Court also stated that "[t]he order in the instant case gives us pause. It obviously is intended for purchasers . . . ." JS App. at 40a. Notwithstanding this finding, the court rejected Northwest Central's constitutional challenge because "federal regulation does not apply to the production or gathering of natural gas" and "[t]he rules on underages are a part of production regulation. . . . ." JS App. at 40a-41a.

3. In his dissent, Chief Justice Schroeder first concluded that the KCC exceeded its statutory authority by setting allowables far in excess of demand, with that action resulting in drainage to intrastate markets that violated the KCC's obligation to protect correlative rights. JS App. at 45a. He also found that "the only viable testimony in the record shows clearly that waste will be caused, not prevented, by the orders, and that correlative rights will be violated not protected by the order." JS App. at 49a.

The Chief Justice further concluded that "[f]ederal preemption . . . nullifies the KCC order." JS App. at 45a. "[I]ts real purpose is to create an impact on purchasers' business decisions concerning the makeup of their interstate gas mix, with an eye toward making it economically prohibitive for such purchasers not to purchase increased substantial volumes of gas from the Kansas Hugoton Field even at the expense of their purchases from other states." JS App. at 46a. Thus, he concluded that the KCC's Rule was unlawful under this Court's "landmark" *Northern* decision. JS App. at 48a-49a.

Finally, the Chief Justice concluded that the result of the KCC's amended rule will be to discriminate in violation of the Commerce Clause against Northwest Central's interstate customers in favor of KP&L's intrastate customers. JS App. at 50a.

4. Northwest Central sought review of *Kansas I* in this Court. On February 24, 1986, *Kansas I* was remanded for further consideration in light of *Transco. Northwest Central Pipeline Corp. v. State Corp. Comm'n of Kan.*, 475 U.S. 1002 (1986).

5. On February 20, 1987, the Kansas Supreme Court (*Kansas II*) affirmed the KCC, for essentially the same reasons given in *Kansas I*. JS App. at 3a. The Chief Justice again dissented from the majority's opinion.

The court concluded that *Transco* was distinguishable because the state regulation there was "addressed to gas purchasers" while "the amendment to paragraph (p) . . . pertains to gas producers," and Congress specifically excluded production and gathering from FERC's jurisdiction under the NGA. JS App. at 11a. The court also found that "any effect on the interstate sale of gas is merely incidental rather than the objective of the order." JS App. at 12a.

In view of the Kansas Supreme Court's decision in *Kansas II*, Northwest Central filed its appeal on March 25, 1987. On May 23, 1988, this Court noted probable jurisdiction.

SUMMARY OF ARGUMENT

I.

The amendment to paragraph (p) is preempted by the Natural Gas Act. The NGA is a comprehensive federal scheme under which the FERC regulates "the

intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States." *Northern*, 372 U.S. at 92. This Court has repeatedly invalidated state actions that interfere with the ability of the FERC to carry out its statutory responsibility to regulate the cost structures of interstate pipelines. In particular, past actions by Kansas and Mississippi to exercise their conservation powers in a manner that forced interstate pipelines to alter their gas purchase decisions have been struck down under the NGA. *Northern*, 372 U.S. 84; *Transco*, 474 U.S. 409. *See also*, *Schneidewind*, 108 S.Ct. 1145; *Exxon Corp. v. Eagerton*, 462 U.S. 176 (1983).

The KCC's order amending paragraph (p) is similar to the actions struck down in *Northern* and *Transco*. Indeed, preemption in the instant case is even more compelling than in either *Northern* or *Transco* because of the additional conflict with FERC's authority over abandonments.

Under the KCC Order, interstate pipelines must increase their current purchases of Kansas-Hugoton gas or suffer the permanent loss of their ability to obtain equivalent quantities of Kansas-Hugoton gas in the future. There can be no doubt that the KCC's purpose was to effect a change in the gas purchasing mix of the interstate pipelines operating in Kansas-Hugoton. The KCC staff witness who proposed the amendment, (J.A. at 50) the Kansas District Court (JS App. at 58a), and the Kansas Supreme Court all stated as much (JS App. at 40a).

The KCC's Order must have one of two consequences. If the KCC succeeds in its announced purpose of forcing increased purchases of Kansas gas by

interstate pipelines, the result will be an interference with FERC rate regulation and a distortion of the national gas market. The FERC regulates and approves the gas purchase mix of interstate pipelines under Sections 4 and 5 of the NGA, 15 U.S.C. §§ 717c, d, and Section 601 of the NGPA, 15 U.S.C. § 3431. Plainly, the FERC cannot regulate in the national interest if the producing states are free to adopt conflicting laws that coerce interstate pipelines into purchasing more in-state gas and concomitantly less out-of-state gas.

If the KCC's order fails to stimulate additional purchases by interstate pipelines, its coercive element will come into play. The permanent cancellation of allowables will cause the permanent abandonment and diversion to the Kansas intrastate market of natural gas which Kansas producers have dedicated to interstate commerce under federal certificates of public convenience and necessity issued pursuant to Section 7 of the NGA. *See, e.g.*, JS App. at 58a. As this Court has recognized, however, the plain language of NGA Section 7(b), 15 U.S.C. § 717f(b), gives FERC alone the authority to allow abandonment. *See United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529. Thus, the NGA preempts any KCC action which results in a *de facto* abandonment of natural gas supplies subject to federal certification under the NGA.

The Kansas Supreme Court distinguished *Northern* and *Transco* on the ground that the regulations in those cases were directed at purchasers, while the current regulation is aimed at producers. This is, however, a distinction without a difference. *Northern*, *Transco* and *Schneidewind* teach that the states cannot exercise their conservation power in a manner

that disrupts the federal scheme. As noted, the clear purpose of the KCC order was to alter pipeline gas purchasing practices which are at the heart of the federal scheme. The KCC's conservation purpose was suspect, and the KCC had other means of regulating production that would not have interfered with the FERC's authority. Under these circumstances, the KCC's order cannot stand.

II.

The amendment to paragraph (p) also runs afoul of the Commerce Clause. The KCC order is *per se* invalid because it discriminates against gas produced in other states. The purpose of the amendment is to coerce interstate pipelines into giving Kansas a relatively larger share of the interstate market at the expense of other producing states. Moreover, the amendment "cements for all time" a "rampant discrimination" against interstate pipelines. JS App. at 50a. Kansas has knowingly allowed intrastate purchasers to drain the gas reserves under acreage dedicated to the interstate market, and has permanently cancelled the right of interstate pipelines to obtain the compensatory or corrective drainage necessary to recapture those reserves in the future. *See, e.g.*, JS App. at 50a.

The KCC order is also unconstitutional under the balancing test of *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970). The order does not serve a legitimate local interest in preventing waste and protecting the correlative rights of producers. The record shows that the KCC order, if anything, will cause waste rather than prevent waste, and destroy correlative rights rather than protect correlative rights. The burden on

interstate commerce is substantial; interstate pipelines in the Kansas-Hugoton must either alter their gas purchase mix or face the loss of dedicated reserves. And, the KCC had alternative methods of preventing waste that would not have burdened interstate commerce.

ARGUMENT

I. THE NATURAL GAS ACT PREEMPTS THE AMENDMENT TO PARAGRAPH (P) AS APPLIED TO INTERSTATE NATURAL GAS COMPANIES

A. The Natural Gas Act Preempts State Regulations Whose Purpose And Effect Are To Control The Purchasing Practices Of Interstate Pipelines Regulated By The FERC

1. This Court has repeatedly invalidated state actions that intrude directly and indirectly upon the authority of the FERC to regulate the rates, terms and conditions at which interstate pipelines make sales for resale in interstate commerce. In the landmark *Northern* decision, 372 U.S. 84, this Court held that the NGA preempted an earlier attempt by the KCC to invade the exclusive jurisdiction of the former FPC to regulate the purchasing practices of interstate pipelines. In that case, the KCC ordered Northern Natural Pipeline Company, and later other pipelines, to purchase ratably from Kansas wells notwithstanding that ratable takes were inconsistent with Northern's contractual relationships. The KCC thus presented Northern with a Hobson's choice of complying with the KCC orders and potentially increasing its rates for FPC-jurisdictional service or refusing to comply and facing criminal penalties.

This Court found that the KCC orders "necessarily deal with matters which affect the ability of the FPC

[now the FERC] to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act." 372 U.S. at 91-92. It recognized that the change in pipeline purchasing practices which Kansas sought to coerce:

> could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States. This relationship is a matter with respect to which Congress has given the Federal Power Commission paramount and exclusive authority.

372 U.S. at 92 (citation omitted). Although a collision between the state-mandated ratable take requirement and the FPC's jurisdiction over the purchasing practices of interstate pipelines was not "an inevitable consequence," this Court found the possibility of collision sufficient to invalidate the state regulation "in order to assure the effectuation of the comprehensive federal regulation ordained by Congress." *Id.*

Transco reaffirmed *Northern* and invalidated a Mississippi ratable purchase order. The state agency argued that the NGA did not preempt its actions because the production was "high-cost" gas within the meaning of Section 107(c)(1) of the NGPA, 15 U.S.C. § 3371(c)(1), which no longer was subject to the FERC's certificate or rate jurisdiction under the NGA. This Court rejected Mississippi's argument because the FERC continued to regulate the gas purchase mix of interstate pipelines. While Congress

substituted market forces for utility regulation in the *wellhead* sale of new and high-cost natural gas, this Court found that "'the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States' . . . is still a subject of deep federal concern." 474 U.S. at 422, *quoting Northern*, 372 U.S. at 92.[17]

Last term, in *Schneidewind*, this Court held that the NGA preempted Michigan from regulating the issuance of securities by interstate natural gas companies, notwithstanding that the FERC did not have express authority to regulate securities' issuances. In so ruling, this Court focused on the purpose of the state action and its effect on the federal regulatory scheme. It concluded that the purpose of Michigan's assertion of jurisdiction was to impose on interstate pipelines the state's conception of reasonable rates and reliable service, matters over which Congress had given the FERC comprehensive authority.[18] *Schneidewind* thus teaches that the dominant factors in preemption analysis are the purposes of the state's activities and their effect on the ability of the FERC

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[17] Four Justices dissented on the ground that "the NGPA's removal of such [high cost] gas from the NGA takes this case outside the purview of *Northern Natural.*" *Transco*, 474 U.S. at 429. The theory of the dissent is not applicable here. As noted earlier, most Kansas-Hugoton gas is "old" gas which remains subject to federal price controls and the NGA's certificate and abandonment jurisdiction. *See* p. 7, *supra*.

[18] The Court found that a "state-ordered alteration in a company's capital structure would impinge on the federal ratemaking authority," and it saw the imminent possibility of collision between a state refusal to approve the issuance of securities for a FERC-approved project. *Schneidewind*. 108 S. Ct. at 1156.

to carry out its Congressionally-mandated responsibilities under the NGA.

2. The KCC's order has the same effect as the orders struck down in *Northern* and *Transco*: to force interstate pipelines to change their gas purchase mix to suit the parochial interests of a single state. The KCC deliberately sets production allowables in excess of overall market demand reflected in the nominations of gas purchasers. By permanently cancelling accrued underages, the amendment to paragraph (p) threatens gas purchasers with the Hobson's choice of compliance or loss of gas reserves. The admitted purpose of this scheme is to coerce interstate pipeline purchasers to produce greater volumes of gas from the Kansas-Hugoton Field. *See* pp. 11, 13-14 *supra*. The KCC pursued this objective with full recognition that increased production of Hugoton gas by interstate pipelines would require decreased gas purchases from other states and could result in the incurrence of expensive take-or-pay liability. *See* J.A. at 54-55.

Thus, the KCC order here transgresses upon the same policies that led this Court to overturn the prior Kansas order in *Northern* and a similar Mississippi order in *Transco*. The KCC order "disturbs the uniformity of the federal scheme" by forcing interstate pipelines "to comply with varied state regulations of their purchasing practices." *Transco*, 474 U.S. at 423. If one state can constitutionally coerce interstate pipelines to change their gas purchase mix to comport with its parochial preference, then other states will surely follow.[19] The FERC's authority to regulate the

[19] Oklahoma has also recently attempted to assert authority to regulate interstate pipeline purchases of gas by regulating

sale and transportation of gas in interstate markets would be circumvented by discriminatory laws or regulations enacted by individual states. The need for paramount federal authority is compelling because only the FERC can regulate in the national interest. *See also Exxon Corp.* v. *Eagerton*, 462 U.S. at 186 (Alabama law which prevented gas producers from passing through increased severance taxes to gas purchasers interferred with FERC's regulation of wholesale price of gas and is preempted).

The KCC Order poses the same possibility of conflict as in *Northern*, *Transco* and *Schneidewind*. Since passage of the NGPA, the FERC has been engaged in the difficult task of regulating the manner in which pipelines, including Northwest Central, roll-in[20] new and high-cost gas with existing supplies of inexpensive, old gas to achieve a price that is fair to the consumer. Indeed, the manner in which Northwest Central blends Hugoton and non-Hugoton gas is currently before the FERC, and has been sanctioned by a FERC Administrative Law Judge who found:

> It was reasonable for Northwest to expect that over the short-term taking more Arkla gas and less lower cost Hugoton gas would

the allocation of production among various categories of wells. This state regulation was held unconstitutional as applied to interstate pipelines in *ANR Pipeline Co., et al.* v. *State Corp. Comm'n*, No. 85-1929A (W.D. Okla, Sept. 2, 1986), *appeal pending*, No. 86-2481 (10th Cir.).

[20] The FERC generally requires interstate pipelines to sell their gas at the average cost of the supply. *See e.g. Columbia Gas Transmission Corp.*, Docket Nos. TA81-1-21, *et al.* (FERC June 16, 1988), slip op. at 7 (pipelines are allowed to average together high and low cost supplies).

> reduce Northwest's higher cost take-or-pay obligations, would keep Northwest's gas costs lower over a longer period by preserving more low-cost supplies for later use, and in the long-term would improve Northwest's competitive posture in acquiring future gas supplies and in pricing those supplies competitively. All these outcomes will benefit Northwest's customers . . . .

Northwest Central Pipeline Corp., 33 FERC (CCH) at p. 65,278.

Kansas apparently disagrees with the reasonableness of this policy. By its amendment to paragraph (p), the KCC would prevent Northwest Central from recovering in the future the low-cost gas it did not purchase currently. Upholding the constitutionality of the KCC order would make Kansas, rather than the FERC, the ultimate arbiter of the gas purchase mix of Northwest Central.

B. The KCC's Order Conflicts With The FERC's Authority To Control Abandonment

1. The KCC's action directly conflicts with NGA Section 7(b), 15 U.S.C. § 717f(b). Section 7(b) bars abandonments of gas, sold under certificates of public convenience and necessity issued under the NGA, without FERC approval.[21] *See* p. 6 *supra*. The conflict arises because the KCC's order would effectuate the permanent abandonment of natural gas reserves dedicated to interstate commerce under federal certificates through the diversion of these reserves to

[21] As discussed at page 7 *supra*, the requirements of the NGA remained intact with regard to this old gas. *See also, United Gas Pipeline v. McCombs*, 442 U.S. at 536 n. 9.

intrastate markets by force of Kansas law. *See* p. 12 *supra*.

The FERC's abandonment authority is exclusive. Under the plain language of NGA Section 7(b), no abandonment or loss of dedicated reserves can occur "without the permission and approval of the Commission [FERC] first had and obtained, after due hearing. . . ." 15 U.S.C. § 717f(b). "The language of § 7(b) simply does not admit of any exception to the statutory procedure." *United Gas Pipe Line Co. v. McCombs*, 442 U.S. at 537. *See also, Sunray Mid-Continent Oil Co v. FPC*, 364 U.S. 137, 141-42 (1960); *Illinois Natural Gas Co. v. Central Ill. Pub. Serv. Co.*, 314 U.S. 498, 508 (1942). *Cf. Chicago & N.W. Transp. v. Kalo Brick & Tile*, 450 U.S. 311 (1981) (action under state statute interfering with the Interstate Commerce Commission's abandonment authority was preempted).

Orders issued by FERC and its predecessor, the FPC, further show a clear conflict between the KCC's amendment to paragraph (p) and NGA Section 7(b). On at least two occasions when interstate pipelines failed to take their allowables from Kansas-Hugoton, natural gas producers sought federal abandonment authority. In 1967, the FPC denied the abandonment application of Ashland Oil Company, finding that such abandonment was not in the public interest. However, the FPC stated that in other cases "the presence of underages and clear evidence of drainage might be an important factor in deciding whether to grant . . . an abandonment." *Cities Service Gas Co.*, 38 FPC at 372.

More recently, after the KCC amended paragraph (p), Cities Service Oil and Gas Corporation, a producer, filed an application with the FERC for the

partial abandonment of its sales from Kansas-Hugoton to Northern Natural Gas Co. on the ground that Northern had failed to purchase gas at the allowables set by the KCC. *Cities Service Oil and Gas Corp.*, 35 FERC (CCH) ¶ 61,071, p. 61,116 (1985). The FERC set the application for hearing (*Id.* at 61,117). The producer subsequently withdrew its application.

Because the KCC's amendment can result in the permanent loss of dedicated natural gas supplies, the KCC would effectively moot FERC's ability to determine whether Kansas-Hugoton producers experiencing underages should be allowed to abandon and resell this gas to another purchaser. If the reserves have already been lost as a result of the KCC's action, then any FERC hearing on an abandonment application would be a hollow exercise.

2. Another aspect of the conflict with FERC's authority to regulate abandonments involves the conflict with NGA Section 7(c), which accords the Commission "plenary" authority over the issuance of natural gas certificates. *Illinois Natural Gas Co.* v. *Central Ill. Pub. Serv. Co.*, 314 U.S. at 510. Like the NGA Section 7(b) conflict, this conflict arises because of the *de facto* abandonment of interstate gas supplies resulting from the KCC's order.

The sales of natural gas by natural gas producers from Kansas-Hugoton to interstate natural gas pipelines, as well as the construction and expansion of facilities to effect those sales, were certificated under NGA Section 7(c). As noted at pages 5-6 *supra*, an important consideration in the granting of certificates for construction and operation of major facilities is the amount of available natural gas reserves to support the use of such facilities.

Two cases involving Northwest Central's predecessor in name, Cities Service Gas Company, demonstrate the FPC's reliance on the availability of sufficient Kansas-Hugoton reserves before issuing a certificate. In the first case, the FPC issued a certificate allowing Cities to increase the capacity of its Kansas-Hugoton line. *Cities Service Gas Co.*, 24 FPC 1127, 1135 (1960). Before issuing the certificate, however, the FPC reviewed Cities' committed reserves in Kansas-Hugoton. The FPC stated that "Applicants' gas reserves appear to be reasonably adequate to support a certificate for the facilities proposed herein."[22] *Id.* at 1134.

In a second case, Cities Service received a certificate for a further expansion of facilities for the transportation of natural gas from Kansas-Hugoton. The FPC again issued that certificate based in large part on its finding that the available Hugoton reserves were sufficient to justify the expansion. *Cities Service Gas Co.*, 38 FPC at 372-374. The FPC stated that "[t]he number of years that the reserves in the Kansas-Hugoton field can produce gas for use in Cities' expanded pipeline, *i.e.*, their deliverability, is an important element of the concept of public convenience and necessity involved in the proposed expansion." *Id.* at 372.[23]

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[22] The KCC supported Cities' application. The KCC believed that "the granting of the certificate requested would alleviate Applicant's underproduced position in the Kansas-Hugoton Field, since the requested capacity would be used to take additional gas from that field." 24 FPC at 1131.

[23] The FPC issued certificates to interstate pipelines, in addition to Cities Service, in reliance on the Kansas-Hugoton reserves. *See, e.g., Northern Natural Gas Co.*, 9 FPC 401 (1950).

Because the KCC's order reduces the dedicated reserves on which the FPC relied in granting certificates associated with the Kansas-Hugoton field, the KCC's amendment to paragraph (p) directly conflicts with NGA Section 7(c). As in *Schneidewind*, 108 S.Ct. at 1155, this conflict demonstrates that the state's action is preempted by the NGA.

C. The KCC's Order Cannot Be Justified On The Theory That It Regulates Gas Production

As noted earlier, the Kansas Supreme Court distinguished *Northern* and *Transco* on the ground that the state regulations in those cases were "addressed to gas purchasers" while the present Kansas order "pertains to gas producers." JS App. at 11a; *see* JS App. at 9a-11a, 40a-41a. It concluded that the NGA did not preempt the Order amending paragraph (p) because "Congress specifically excluded production and gathering from the FERC's jurisdiction under the Natural Gas Act." JS App. at 11a. These arguments miss the point of this Court's decisions.

The Natural Gas Act not only precludes direct regulation by the states of the contractual relationship between pipelines and their customers, but "[t]he federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, or for state regulations which would indirectly achieve the same result." *Northern*, 372 U.S. at 91 (citation omitted). Even if Kansas were legitimately engaged in regulating gas production, the Constitution does not allow Kansas to exercise its conservation power through "means [that] threaten effectuation of the federal regulatory scheme." *Id.* at 93. *Cf.*, *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 56 U.S.L.W. 4751

(U.S. June 24, 1988)(No. 86-1970). Regardless of the state's characterization of its actions, the ultimate question is whether the state's action in substance "amounts to a regulation in the field of gas transportation and sales for resale that Congress intended FERC to occupy." *Schneidewind*, 108 S.Ct. at 1153. Where, as here, the state's order admittedly is intended to influence the gas purchase decisions of interstate pipelines and substantially interferes with the federal scheme, its constitutionality cannot turn on whether the order nominally operates on producers and production.[24]

Just as the states cannot use their "undoubted jurisdiction over retail sales" to alter FERC-ordered allocations of electric power under the Federal Power Act, *see Mississippi Power & Light Co.* v. *Mississippi ex rel Moore*, 56 U.S.L.W. at 4756, the state of Kansas cannot use its conservation jurisdiction to alter FERC-approved allocations of gas purchases by interstate pipelines or to pretermit such approval. Although the states may lawfully determine how much gas is available for purchase from their fields, they

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[24] Twenty-five years earlier in the landmark *Northern* case, the FPC forcefully argued that pre-emption decisions cannot rest on a mechanical inquiry into whether a state's orders nominally are directed at purchasers or producers. Pointing out that a regulation limiting the volume a pipeline could purchase from a specific well would be equivalent to a limitation upon the production of that well, the FPC stated that "it is necessary to look beyond [the] nominal subject matter [of the regulations] and attempt to discern the degree and nature of their impact upon interstate commerce." Memorandum for the Federal Power Commission as Amicus Curiae, Northern Natural Gas Co. v. State Corp. Comm'n, Sup. Ct. No. 62, October Term 1962 at 25.

may not seek to coerce pipelines into purchasing the gas that they have determined to be available.

Moreover, the conservation purpose of the KCC order is suspect. The Kansas Supreme Court rejected the KCC's interpretation of correlative rights as contrary to the Kansas statute and the KCC's own regulations. JS App. at 25a-26a. It never explained how the correlative rights of underproduced operators, who were being drained by overproduced wells, were protected by an order which permanently terminated their rights to obtain compensating future drainage. *See* pp. 12-14, *supra*. The dissent's conclusion that the KCC order is not a valid conservation measure "because the only viable testimony in the record shows clearly that waste will be caused, not prevented, by the orders, and that correlative rights will be violated not protected" (JS App. at 49a) is well taken. It lays bare Kansas' improper purpose to create an artificial demand for Kansas production at the expense of other states and to interfere with the jurisdiction of the FERC.[25]

[25] It is also relevant that Kansas could have prevented waste and protected correlative rights without impinging upon the federal scheme by ceasing its practice of setting allowables in excess of market demand. *See Northern*, 372 U.S. at 94. The KCC, however, rejected this approach because it would have limited the ability of overproduced operators to continue taking more than their proportionate share of available reserves. JS App. at 73a. But this determination had nothing to do with protecting the correlative rights of underproduced operators who were being drained by overproduced operators. As noted in the dissenting opinion, the overproduced operators largely served local Kansas markets. Thus, the practice of setting allowables in excess of the overall market demand "created rampant discrimination" in favor of intrastate markets, which the cancellation of past underages would "cement for all time." JS App. at 50a.

II. THE KCC'S ORDER IMPERMISSIBLY BURDENS AND DISCRIMINATES AGAINST INTERSTATE COMMERCE IN VIOLATION OF THE COMMERCE CLAUSE

The Commerce Clause, Article 1, Section 8, Clause 3, grants to Congress the authority to "regulate Commerce . . . among the several States." This affirmative grant of federal power is a self-executing limit on state power to regulate interstate commerce. *See, e.g., New Energy Co. v. Limbach*, 56 U.S.L.W. 4475, 4476 (U.S. May 31, 1988) (No. 87-654); *H.P. Hood & Sons v. Du Mond*, 336 U.S. 525, 534-35 (1949). "[T]he commerce clause prohibits economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *New Energy*, 56 U.S.L.W. at 4476 (citations omitted).

Even if the Natural Gas Act had never been passed, the KCC's order would exceed the limits of state regulatory power under the Commerce Clause. The KCC's order impermissibly burdens interstate commerce by coercing pipelines to give Kansas a larger share of the interstate gas market at the expense of interests in other states. Moreover, the order "cements for all time" a "rampant discrimination" against interstate commerce, in which producers that serve local Kansas markets are allowed to drain gas from producers who have committed their acreage to the interstate market. JS App. at 50a.

In *Brown-Forman Distillers Corp. v. New York Liquor Auth.*, 476 U.S. 573 (1986), this Court described its Commerce Clause analysis of state economic reg-

ulation as "a two-tiered approach." When this Court finds that "a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests," it generally has "struck down the statute without further inquiry." 476 U.S. at 579 (citations omitted). *See also, New Energy*, 56 U.S.L.W. at 4476. However, when it finds that "a statute indirectly affects interstate commerce and regulates evenhandedly," the Court will declare the law unconstitutional where the burden on interstate commerce exceeds the benefits derived by the state from its actions.[26] The KCC Order is unconstitutional under both tests.

The KCC order is simple economic protectionism. The admitted purpose of the amendment to paragraph (p) is to force interstate pipelines to take more gas from Kansas and less from other states upon penalty of losing their gas to the intrastate market. Moreover, the KCC order promotes the kind of favoritism of local interests that the Commerce Clause was intended to eliminate.

In *Pennsylvania v. West Virginia*, 262 U.S. 553 (1923), this Court held that, under the Commerce Clause, a state may not allocate the supply of its natural resources in a way that favors local users at

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[26] *Brown-Forman*, 476 U.S. at 579, *citing Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970). There is no clear division between state regulations that are invalid *per se* under the Commerce Clause and those whose validity can be determined after balancing state and local interests. *Brown-Forman*, 476 U.S. at 579. In either case, this Court's analysis focuses on the practical effect of the statute. *Id.* If the state law "is in reality 'simple economic protectionism,' " then it is *per se* unconstitutional. *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 471 (1981).

the expense of out-of-state consumers. Yet, for many years, Kansas has discriminated against out-of-state purchasers under the guise of enforcement of conservation laws. Kansas law purports to protect the correlative rights of all operators—that is, the right of each interest owner in a common pool to obtain his or her proportionate share of reserves. *See* Kan. Stat. Ann. § 55-703, JS App. at 111a. But, the KCC has consistently established allowables in excess of the market demands of interstate pipelines knowing that this action would allow those operators who were primarily connected to local Kansas markets to overproduce their wells and create drainage in their favor.[27] This discrimination was permissible as long as it could be reversed in the future. However, by permanently cancelling underages, the KCC order eliminates the ability of interstate pipelines to obtain "the corrective or compensatory drainage which was the hallmark of the prior [KCC] orders for years." JS App. at 50a. The effect is "to cement for all time" the discrimination against out-of-state-purchasers. "[Kansas] intrastate purchasers will benefit, and Northwest Central interstate customers will be prejudiced." *Id.* This is impermissible. A state may not legitimately seek to protect its citizens by placing itself in a position of economic superiority, ignoring problems common to all and forcing others to bear the burden of its regulations. *See Philadelphia v. New Jersey*, 437 U.S. 617 (1978).

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[27] As the dissent explains, the KCC practice "of setting allowables in excess of the actual market demand [has] created rampant discrimination between the wells in the field." JS App. at 50a.

The KCC's order similarly cannot pass muster under the balancing test of *Pike v. Bruce Church*.[28] First, the amendment to paragraph (p) does not regulate evenhandedly. As shown above, it effectively discriminates against out-of-state interests.

Second, the order does not serve a legitimate local interest in preventing waste and protecting correlative rights. The only competent evidence was that "waste will be caused, not prevented . . . and correlative rights will be violated not protected by the order." JS App. at 49a. The evidence showed that leases connected to interstate pipeline systems were being drained by the disproportionate takes of operators connected to intrastate lines. Neither the KCC, the District Court nor the Kansas Supreme Court ever explained how terminating the right of the operators suffering drainage to obtain "corrective or compensatory drainage" in the future protected their correlative rights.[29]

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[28] In applying this balancing test, "the extent of the burden [on interstate commerce] that will be tolerated . . . depend[s] upon the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities." *Pike v. Bruce Church*, 397 U.S. at 142.

[29] *Cf. Thompson v. Consolidated Gas Util. Corp.*, 300 U.S. 55 (1937). In *Thompson*, this Court invalidated, as an unconstitutional taking of property, a Texas proration order which did not bear a reasonable relation to the prevention of waste or the protection of correlative rights. The Court found that the purpose of the order was to prorate distant markets, which was not within the power of Texas to accomplish. While *Thompson* did not rest on Commerce Clause grounds, the opinion reflects Commerce Clause concerns. The states may not exercise their conservation power for the purpose of influencing the economic choices of out-of-state interests.

Third, the burden on interstate commerce is substantial. It is undisputed that out-of-state pipelines must purchase more Kansas gas and less gas from other states or lose their right to obtain Kansas gas in the future. If Kansas can successfully coerce interstate pipelines to change their purchase mix, other producing states necessarily will follow suit to protect their interests. The Commerce Clause protects the flow of interstate commerce against such state protectionism.

Finally, Kansas has alternative methods to protect its interest in preventing the waste of its gas resources and protecting correlative rights without burdening interstate commerce. Rather than attempting to create an artificial market for Kansas gas at the expense of other states, Kansas could have established its production allowables in line with market demand. *See* JS App. at 46a. In this way, Kansas would have adjusted supply to meet demand, rather than improperly attempting to force up demand to meet supply.

In sum, the attempt by Kansas to alter the interstate gas market to favor its own gas production and consumers at the expense of other states, interstate pipelines and interstate gas consumers violates the Commerce Clause. It threatens to disrupt the national gas market by encouraging other states to retaliate, to the ultimate detriment of the national interest.

CONCLUSION

For the foregoing reasons, the KCC's Order (JS App. D) violates the Supremacy and Commerce Clauses of the United States Constitution and, therefore, the judgment of the Kansas Supreme Court should be reversed.

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July 7, 1988

APPENDIX

NATURAL GAS ACT

SECTION 4
15 U.S.C. § 717c

RATES AND CHARGES; SCHEDULES; SUSPENSION OF NEW RATES

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such

rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed, the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go

into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

NATURAL GAS ACT

SECTION 5
15 U.S.C. § 717d

FIXING RATE AND CHARGES; DETERMINATION OF COST OF PRODUCTION OR TRANSPORTATION

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, Municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: Provided, however, That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

NATURAL GAS ACT

SECTION 7
15 U.S.C. § 717f

EXTENSION OF FACILITIES; ABANDONMENT OF SERVICE

(a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: Provided, That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c)(1)(A) No natural-gas company or person which will be a natural-gas company upon completion of any proposed

construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate for public convenience and necessity issued by the Commission authorizing such acts or operations: Provided, however, that if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

(B) In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereof to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: Provided, however, That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the

issuance of a certificate will not be required in the public interest.

(2) The Commission may issue a certificate of public convenience and necessity to a natural-gas company for the transportation in interstate commerce of natural gas used by any person for one or more high-priority uses, as defined, by rule, by the Commission, in the case of—

(A) natural gas sold by the producer to such person; and

(B) natural gas produced by such person.

(d) Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form; contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation, require.

(e) Except in the cases governed by the provisos contained in subsection (c)(1) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

(f) The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which each authorization under this section is to be

limited. Within such service area as determined by the Commission a natural-gas company may enlarge or extend its facilities for the purpose of supplying increased market demands in such service area without further authorization.

(g) Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company.

(h) When any holder of a certificate of public convenience and necessity cannot acquire by contract or is unable to agree with the owner of property to the compensation to be paid for, the necessary right-of-way to construct, operate, and maintain a pipe line or pipe lines for the transportation of natural gas, and the necessary land or other property, in addition to right-of-way, for the location of compressor stations, pressure apparatus, or other stations or equipment necessary to the proper operation of such pipe line or pipe lines, it may acquire the same by the exercise of the right of eminent domain in the district court of the United States for the district in which such property may be located, or in the State courts. The practice and procedure in any action or proceeding for that purpose in the district court of the United States shall conform as nearly as may be with the practice and procedure in similar action or proceeding in the courts of the State where the property is situated: Provided, That the United States district courts shall only have jurisdiction of cases when the amount claimed by the owner of the property to be condemned exceeds $3,000.

APPELLEE'S

BRIEF

(10)

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No. 88-1256

In The
Supreme Court of the United States
October Term, 1987

NORTHWEST CENTRAL PIPELINE CORPORATION,
Appellant,

vs.

STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, et al.,
Appellees.

On Appeal After Remand To
The Supreme Court of Kansas

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QUESTIONS PRESENTED

1. Whether an order issued by the State of Kansas for the purpose of promoting the state's legitimate interest in protecting correlative rights and preventing waste of its mineral resources in the exercise of its exclusive jurisdiction over production and gathering of natural gas as reserved to the state by Congress in Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b), is pre-empted by the jurisdiction of the federal government pursuant to the Supremacy Clause of the United States Constitution.

2. Whether an order issued by the State of Kansas pursuant to its exclusive jurisdiction over the production and gathering of natural gas as reserved to the state by Congress in Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b), that is properly confined to such jurisdiction, creates any impact which is violative of the Commerce Clause of the United States Constitution.

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No. 86-1856

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Appellees.

On Appeal After Remand To
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BRIEF FOR THE APPELLEE

STATEMENT OF THE CASE

At issue in this case is the constitutionality of an order entered by the Kansas Corporation Commission (Commission) pursuant to its authority to protect correlative property rights and conserve the state's natural gas resources.

A. Proceedings Below

On February 16, 1983, the Commission issued its order amending paragraph (p) of the Basic Proration Order for the Kansas Hugoton Gas Field.[1] JS App. at 63a.[2] This

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[1] Paragraph (p) of the 1944 Basic Proration Order specifically provided, until the action at issue here, that (1) any well must be "shut-in" if the well has overproduced its allowable by a cumulative amount equal to six times its allowable for the month of January; (2) if any well fell short of pro-

(Continued on following page)

amendment permanently cancelled underages (unproduced allowables) unless the underages are reinstated and produced within specified time periods.[3]

The Commission affirmed its order on rehearing. Appellant, joined by others, petitioned for review of the Commission's amendment to paragraph (p) in the District Court of Gray County, Kansas. JS App. at 81a. The district court affirmed the Commission on November 7, 1983. JS App. at 53a. The district court found that "[s]ince this KCC Order deals with the producers of natural gas it falls within the specific exemption of the Federal Natural Gas Act . . . allow[ing] the State to regulate

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(Continued from previous page)

ducing its allowable by a cumulative amount equal to six times the prior January allowable, this shortfall would be cancelled and the producer required to apply to the Commission to reinstate the cancelled underage before later making up the shortage; and (3) cancelled underages will be reinstated upon a "showing that the wells are in an overproduced status; that the purchaser is willing and able to take the amounts of gas; and that the length of time proposed by applicant for the production of the amounts of gas to be reinstated is reasonable under the circumstances." There was no permanent cancellation of these allowables. *See* JS App. at 68a.

2 References herein to "JS App." are to the Appendix filed with the Jurisdictional Statement. References to "J.A." are to the Joint Appendix filed with appellant's brief.

3 The amendment specifically provides that: (1) underages cancelled before 1975 could be reinstated only if reinstatement had been requested by the end of 1983; (2) underages cancelled from January 1, 1975, through December 31, 1982 could only be reinstated if reinstatement was requested by December 31, 1985, and only if the well was in an overproduced status at the time of the request; and (3) underages cancelled after December 31, 1982, could only be reinstated within three years of the cancellation and only if the well was in an overproduced status at the time of the request. JS App. at 68a-69a.

the 'production or gathering' of natural gas." JS App. at 59a.

On May 10, 1985, the Kansas Supreme Court issued its first opinion (*Kansas I*) affirming the Commission's order. *Northwest Central Pipeline Corp. v. State Corp. Comm'n. of Kansas*, 237 Kan. 248, 699 P.2d 1002 (1985). JS App. at 13a-52a. The court specifically rejected appellant's constitutional challenge observing that "federal regulation does not apply to the production or gathering of natural gas." JS App. at 40a-41a. The court further noted that "the matter of allowables must be construed to pertain to production." *Id.* at 41a. The court found that "the rules on underages are a part of production regulation" falling within the production and gathering exemption of the Natural Gas Act (NGA). *Id.*

Appellant sought review of *Kansas I* in this Court. This Court remanded *Kansas I* to the Kansas Supreme Court for further consideration in light of *Transcontinental Pipe Line Corp. v. State Oil & Gas Board*, 474 U.S. 409 (1986) (*Transco*). *Northwest Central Pipeline Corp. v. State Corp. Comm'n. of Kansas*, 475 U.S. 1002 (1986).

On February 20, 1987, the Kansas Supreme Court issued its second opinion (*Kansas II*) affirming the Commission's order. *Northwest Central Pipeline Corp. v. State Corp. Comm'n. of Kansas*, 240 Kan. 638, 722 P.2d 775 (1987). JS App. at 1a-12a. The court distinguished *Transco* on grounds that the state regulation there was "addressed to gas purchasers" while "the amendment to paragraph (p) . . . pertains to gas producers," and Congress specifically excluded production and gathering from the jurisdiction of the Federal Energy Regulatory Commission (FERC) under the NGA. JS App. at 11a. The court

held that "any effect on the interstate sale of gas is merely incidental rather than the objective of the Order." JS App. at 12a.

On March 25, 1987, appellant appealed *Kansas II* to this Court. On May 23, 1988, this Court noted probable jurisdiction. *Northwest Central Pipeline Corp. v. State Corp. Comm'n. of Kansas*, 56 U.S.L.W. 3801 (U.S. May 24, 1988) (No. 86-1856).

B. Regulatory Background

FERC has jurisdiction over all activities pertaining to the transportation and sale for resale of natural gas in interstate commerce. Production and gathering of natural gas, however, is reserved to the jurisdiction of the states.

Congress specifically exempted "production and gathering" from FERC's jurisdiction in Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b). JS App. at 98a. Congress recognized that each state, not the federal government, should have primary jurisdiction over activities involving the use of its own mineral resources. *See, e.g., Interstate Natural Gas Co. v. Federal Power Com'n.*, 331 U.S. 682, 689-691 (1947). Through the "production and gathering" exemption, each state possesses latitude within which it may regulate to prevent the waste of natural gas and protect correlative property rights in the mineral resources. *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179, 186 (1950).

Prior to enactment of the NGA, the Kansas legislature charged the State Corporation Commission with the duty to regulate the production of natural gas so as to prevent waste and protect correlative rights. Kan. Stat. Ann.

§§ 55-701-705a (Weeks 1976). JS App. at 110a-114a. Through Kan. Stat. Ann. § 55-703 (Weeks 1976), the Commission has the authority to prorate production of natural gas from a common source of supply. The purpose of proration is "to permit each developed lease to ultimately produce approximately the amount of gas underlying the developed lease and currently produce proportionately with other developed leases in the common source of supply without cognizable drainage between separately owned, developed leases or parts thereof." Kan. Stat. Ann. § 55-703 (Weeks 1976). JS App. at 111a-112a.

The state's authority over production and gathering of natural gas has been significantly shaped by various decisions of this Court. No single case has had a greater impact upon the jurisdictional boundaries between state and federal regulation of natural gas than *Northern Natural Gas Co. v. State Corp. Comm'n. of Kansas*, 372 U.S. 84 (1963).

THE NORTHERN NATURAL CASE

In *Northern*, the Court found that the State of Kansas had unconstitutionally ordered interstate pipelines to take ratably from all wells producing in the Hugoton reservoir. The Court clearly distinguished between federal and state regulatory jurisdiction holding that the federal government had exclusive authority over the transportation and sale for resale of natural gas. Because the pipelines bought and sold gas in interstate commerce, the state had no authority to direct any aspect of that activity even under color of state police power. Rather, the state's regulatory jurisdiction was confined to the production and gathering of natural gas.

The *Northern* Court discussed in elaborate detail the extent and purpose of the state's authority. "There is no doubt that the States do possess power to allocate and conserve scarce natural resources upon and beneath their lands. We have recognized such power with particular respect to natural gas." *Northern*, 372 U.S. at 93. Referring to *Champlin Refining Co. v. Corporation Commission*, 286 U.S. 210 (1932), the Court stated, "such production is essentially a mining operation and therefore is not a part of interstate commerce . . ." *Northern* at 94. The Court continued:

> Thus our cases have consistently recognized a significant distinction, which bears directly upon the constitutional consequences, between conservation measures aimed directly at interstate purchasers and wholesales for resale, and those aimed at producers and production. *Id.*

C. Prorationing and the Basic Proration Order for the Hugoton Gas Field.

Two major objectives of conservation regulation are to prevent waste and protect correlative rights. Governing bodies from each gas producing state are confronted with the same problem in meeting these objectives. Natural gas within the subsurface confines of a field tends to migrate from underproduced areas to produced areas because natural gas flows from high pressure areas to low pressure areas. JS App. at 17a-18a. The various prorationing schemes developed by the states are designed to ensure that each developed lease produces its fair share

of underlying reserves in spite of the natural phenomenon of drainage caused by migration.

In Kansas, the Commission exclusively regulates natural gas by field with general rules for each field, specified in a basic proration order. Prorationing generally regulates the placement and number of wells in a field and restricts assignment of production (allowable) to each well in a field.

The Hugoton Basic Proration Order establishes an allowable formula used by the Commission in calculating the monthly production allowable for each well. *See generally*, J.A. at 11-24. The formula takes into consideration the acreage attributed to the well, the deliverability of the well, and the current market demand for gas on a field-wide basis. A producer must petition the Commission for an order granting his well an allowable assignment. Kan. Admin. Regs. § 82-3-300 (1982). The allowable assignment specifies the amount of gas that the well is allowed to produce.

In the Hugoton Basic Proration Order the Commission identified several factors in the allowable formula. First, well spacing was originally set at a density of one well per 640 acres.[4] J.A. at 12. Next, the deliverability

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[4] In 1986, the Commission entered an order allowing a second well to be drilled upon most units. Docket No. C-164 dated July 18, 1986

of each well is determined by running pressure tests upon each well. J.A. at 18. Wells with higher deliverability generally receive higher allowable assignments than lower-pressured wells of equal acreage.

The third factor, market demand for the field, is determined semi-annually from evidence of market demand for gas from the Hugoton Field for the coming six-month period. J.A. at 22. Among the evidence presented are the pipeline purchasing companies' nominations. The nominations submitted represent the amount of gas that each pipeline purchasing company expects to take from the field during the subject market period.[5] These nominations are considered by the Commission along with other market-influencing factors in arriving at a final market demand figure.[6]

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5 As noted at hearing, the purchasers' nominations do not always reflect what the purchaser actually ends up taking from the field during the subject period. J.A. at 64.

6 K.S.A. § 55-703 (Weeks 1976) requires in part, that in determining the market demand the Commission must "consider the reasonable current requirements for current consumption and use within and without the state and such other factors, conditions, or circumstances that would aid in establishing the market demand." JS App. at 111a-113a. Gauging the future consumer demand for Hugoton gas is a task with inherent difficulties. The Commission's record, as demonstrated by exhibit 17 admitted at hearing, shows that the field allowable set by the Commission fell both above and below the actual production amount in the nineteen years preceding the hearing. See Appendix B. Clearly, the exhibit refutes appellant's factual statement that "[S]ince 1956, the practice of the KCC has been to fix production far in excess of the overall demand for gas."

(Continued on following page)

This final figure represents the estimated total demand for Hugoton gas and represents the field-wide allowable for the subject period.[7] By statute, this allowable must be spread fairly and evenly among all wells in the field by factoring in each well's deliverability and attributable acreage. JS App. at 111a-113a. The result is the assignment of an individual allowable to each well in the field with each allowable being comparable when considering acreage, deliverability and market demand. Through the assignment of allowables on a well-by-well basis, the Commission fulfills its statutory duty to see that each well produces only its fair share of underlying reserves. Over time, this ensures a balanced draining of the reservoir. While the Commission's regulation of the Hugoton Field has been challenged over the years on many occasions, it is important to note that all parties agree that the allowable formula is the best approach to prorating the field. JS App. at 73a.

The Commission's regulatory scheme for prorating the Hugoton Gas Field presupposes that all wells are producing gas at all times. In reality, a gas well produces only when its purchaser is taking the gas. Many wells are

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(Continued from previous page)

Appellant's brief at 9. The exhibit is also instructive in that it shows that in all but four of the nineteen years, allowables were set below the purchasers' own nominations.

7 It is noteworthy that while the appellant is now critical of the Commission's market demand record (Appellant's brief at 9), nevertheless, no party, including the appellant who participates in every market demand proceeding, has challenged a Commission order setting market demand since the early 1960s. Only recently was such an order appealed, upon the assertion that the total allowable figure was too low. Docket No. C-164 dated June 15 ,1988.

shut-in during times when its pipeline purchaser is not taking the available gas. In a field such as the Hugoton, with multiple pipeline purchasers, a great number of wells are shut-in at a wide variety of times. The Commission has long recognized that such divergent rates of take occur and has promulgated orders to ensure that problems created by shut-in wells are corrected. JS App. at 17a-18a, 56a-57a.

D. The Commission's Order.

Prior to amendment of Paragraph (p), the order permitted any well with an adjusted deliverability in excess of 300 Mcf[8] to accumulate under-production equal to six times the amount of the current allowable assigned to the well for the preceding January. Any amount in excess of this accumulated underproduction was cancelled. However, cancelled underage could be reinstated at any time if the producer could show the well was in an over-produced status, that a purchaser was willing and able to take the gas, and a reasonable time was proposed for the production of such gas.[9] J.A. at 23-24.

On March 15, 1982, the Commission instituted a general investigation into the provisions of the Basic Hugoton

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[8] 300,000 cubic feet of gas per day.

[9] The requirements that the subject well be in an overproduced status and that the applicant identify its purchaser at the time of filing have since been removed. These restrictions were lifted to enhance the producer's ability to participate in the open "spot" market thereby complementing current FERC policy objectives. See Appendix C at 15a.

Order. The Commission had become increasingly concerned over the exorbitant amounts of cancelled underage accumulating from wells in the Hugoton Field. As a result of the general investigation, the Commission called for a hearing to consider whether changes should be made to the policy concerning underproduction and overproduction in the Hugoton Field. J.A. at 29.

On February 16, 1983, the Commission changed its policy of reinstating cancelled underages by amending paragraph (p). This order set forth three vintage periods during which cancelled underage must be reinstated or permanently cancelled. JS App. at 63a, 74a. The Commission's findings were drawn from two days of testimony.

While the Hugoton Field had experienced varying degrees of cyclical underproduction in the past, the situation in 1982 was unusually severe and getting worse. JS App. at 56a. Some of the decline in gas production could be attributed to an overall market declien. However, the Hugoton Field was suffering a proportionately greater reduction in takes or purchases than other fields from which Hugoton purchasers were buying gas. J.A. at 99, 129-133. Testimony at the hearing indicated that the field was being used as a storage field by many of the interstate purchasers. J.A. at 47, 129-133. This practice was made easier by the less restrictive tolerance provisions imposed by the Hugoton Field rules. J.A. at 48, 73-74.

Experts testified that the lack of uniform production was taking a toll on the field. Uncompensated drainage was causing the field to become badly imbalanced and violating correlative rights with no sign that the situation was improving. J.A. at 32-33, 35, 42-44, 122-123. By stat-

ute, the Commission was required to regulate the production of natural gas in a manner which would prevent "uncompensated cognizable drainage" between wells or leases in the same common source of supply. See Kan. Stat. Ann. § 55-703 (Weeks 1976). JS App. at 113a. Consequently, the Commission was obligated to identify the problem and take corrective action.

Uncompensated drainage is undesirable for two reasons. First, it violates the correlative rights of adjacent producers. Second, it increases the potential for waste of natural gas. As gas migrates from higher pressure to lower pressure, some gas is eventually "lost" in the formation as it migrates because of dissipation of the pressure forces. *See generally* 8 H. Williams & C. Meyers, Manual of Oil and Gas Terms, pp. 198, 716-717, 869-871, 1061 (1987). Sometimes drainage violates the correlative rights of the producers of the wells which are producing regularly. Other times the correlative rights of the producers of shut-in wells are harmed by drainage. Below are summarized hypothetical examples of both cases as discussed at the hearing, and upon which the Commission relied in issuing its order. J.A. at 65-68, 99-105, 135-136.

In example (1), pipeline (P) has contracted to purchase gas from producer (A) and producer (B). The market demand is 100 BCF. A and B have equal deliverability capability of (X), and each have 640 acres attributed to their respective wells. When these factors are computed through the Commission's allowable formula,

the wells are assigned the same allowable. During period one, producer A is shut-in to the extent that he accumulates excess underage which is cancelled. During the same period, producer B produces his entire allowable. Over the next two periods of production, A is shut-in completely while B continues to produce. By this time B, who has been producing all along, has a deliverability of less than (X) due to decreasing shut-in pressure. Therefore, B is assigned a lower allowable than A. Meanwhile, A continues to have underage cancelled at a rate equal to or higher than the original allowable, because, over time, his shut-in pressure has risen.[10]

This continues for many periods as B's allowable is gradually reduced and A continues to receive an increasing allowable assignment, which is cancelled every period. For all practical purposes, A is "banking" his underages to be spent later.[11] After many periods, A will reinstate and produce this cancelled underage. If the pipeline then decides to take a lot of gas, A may reinstate and produce all of its backlog of cancelled underage in a short period of time. In this event, B, who will be producing less at a

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10 Deliverability is a function of wellhead pressure. If two wells have the same attributable acreage, the well with the higher deliverability pressure will receive a higher allowable. Consequently, wells that have been shut-in for prolonged periods of time will not be penalized by having their back-underages cancelled. This is because the shut-in well maintains its higher pressure. Therefore, it will continue to receive a higher allowable until it produces enough gas to lower its pressure.

11 Prior to the Commission's 1983 Order amending paragraph (p) of the Basic Proration Order for the Hugoton Field, A was free to save its artificially high allowables/underages indefinitely.

lower allowable, may have its gas drained away to fulfill A's greater demand upon the reservoir. Over a stretch of ten periods, A will have accumulated an allowable of at least ten times the original allowable. B will have been assigned a gradually reduced allowable over the same ten periods. If, in the tenth period, A reinstates and produces all of its backlog, A will have produced much more gas than B, and possibly at B's expense.

This example evidences the real potential for harm to the correlative rights of producers. Recognizing its duty to prevent this violation of rights from the inequitable production of gas, the Commission amended paragraph (p) to discourage wells from remaining shut in thereby banking high allowables indefinitely in encouraging timely production through the cancellation of antiquated underages, the Commission is not forcing A to produce or the purchaser to purchase.

Example (2) presents an even simpler demonstration of drainage caused by extended period of non-production. In this scenario, it is the shut-in producer who is the victim of drainage. Here, the shut-in producer (A) is surrounded by producing wells which are draining gas from under A's acreage. A will be accumulating cancelled underage which may, of course, be reinstated and produced at a later date. Unless the drainage from the shut-in wells is stopped, A may be unable to produce his entire accumulated underage by the end of the field's life. Therefore, A may never recover his share of reserves.

Paragraph (p), as amended, does not force A in the example above to produce. Rather, the Commission has attempted to ensure that other producers in the field are not harmed by A's decision to remain shut-in. The Commission's order encourages A to stop the drainage by producing in a timely manner.

The Commission concluded the problem with correlative rights did not result from the assignment or level of allowables, but rather from the failure of producers and pipelines to take from the field.[12] JS App. at 73a. Furthermore, the Commission considered the best way to correct the ongoing violations of correlative rights would be to implement a new policy designed to encourage timely production of allowable assignments. JS App. at 74a-75a. Therefore, the Commission issued its order amending paragraph (p) of the basic proration order.

SUMMARY OF ARGUMENT

The Commission's order of February 16, 1983, is an exercise of a legitimate state interest in preventing waste and protecting correlative rights. The authority to regulate matters pertaining to the production of allowables is specifically reserved to the states by the production and gathering exemption of the Natural Gas Act. Given the deteriorating condition of the Hugoton Reservoir from imbalanced production, the Commission was compelled by statutory duty to investigate and correct any problems arising from reduced production in the field.

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[12] The Commission determined that lowering allowables to meet nominations would be an exercise in futility because purchasers' nominations do not always reflect what the purchasers actually take. J.A. at 63-64. Testimony indicated that no matter where allowables were set, some purchasers were just not taking gas. J.A. at 64.

Upon conclusion of a full evidentiary hearing, the Commission found correlative rights violations resulted from drainage, not the assignment of allowables. JS App. at 73a. The Hugoton Field became badly imbalanced and correlative rights were being violated because shut-in wells were causing uncompensated drainage. The allowable assignments of both producing and non-producing wells were also adversely affected by this uncompensated drainage. The longer a well remains shut-in, the more unrealistically high the allowable assignments become. Because the Commission is without authority to order production from shut-in wells, it undertook a policy to ensure that allowable assignments do not impart an unfair advantage to either the producing or non-producing well. The cancellation of underage is simply the removal of an outdated allowable.

To equate the actions of permanently cancelling underages with the actual removal of existing gas reserves in the ground is erroneous. Obviously, cancelling the underage from Commission records does not take the gas out of the ground. The gas is still in place and can be produced under new allowables as they are assigned by the Commission. The change in policy is designed to guarantee gas will be conserved and every well will deplete only its own share of underlying reserves. Prolonged drainage caused by shut-in wells will only further aggravate the underage situation.

The purchaser has not lost the opportunity to take assigned underages as his taking them is only restricted by time. The purchaser can take all of the producer's previously assigned allowables within a reasonable time or

wait until new assignments replace any amounts which have been permanently cancelled. In this manner, the Commission encourages the practice of conservation. The order does not force either participant to take any action but simply offers a choice. The Commission is not blind to the fact that purchasers play an important role in the decision to produce gas; however, the Commission recognizes it lacks jurisdiction over purchasers. The order is intended to balance the Hugoton Field by the proper regulation of producers, over whom the Commission has jurisdiction.

The Commission's action is entirely appropriate because the reserves belong to the producer, not the purchaser. As such, allowables are assigned to the producer, who owns the underage. J.A. at 54, 68. Consequently, the producer must reinstate the cancelled underage or suffer permanent cancellation. A producer's arrangement to sell its reserves to a certain purchaser is a private contractual relationship in which the Commission is not involved. That the order may indirectly affect a purchaser's decision to take more gas is a reasonable possibility. This mere possibility should not preclude the Commission from properly exercising its Congressionally-recognized jurisdiction.

I.

Congress expressly created a dual regulatory scheme between the state and federal governments in the Natural Gas Act. As a result, Congress did not intend federal regulation to supersede all state regulation of natural gas. Because the Commission's order strictly adheres to the state's designated field of regulation over production and gathering activities, a finding of explicit pre-emption is precluded.

The Commission's order bears little resemblance to the state regulation found to disrupt the uniformity of the federal scheme as discussed in *Northern* and *Transco*. The orders in both *Northern* and *Transco* were directed at interstate purchasers and required their ratable taking of gas. These state actions raised the imminent possibility of collision between state and federal law and created the likely disruption of the federal scheme.

In contrast, the order in the case at bar is directed only at the producers in the Hugoton Field. The pipeline purchasers are not required to take action, nor are they required to refrain from taking action. No intrusion upon the federal scheme exists because the state subordinated its regulation by directing its order to producers.

The propriety of the Commission's order as a legitimate conservation measure has twice been affirmed by the Kansas Supreme Court. The Commission by amending its proration order has acted exactly as the *Northern* court suggested. Nullification of the state's authority to enforce its allowable assignments will render the state's prorationing scheme meaningless as a conservation tool. Such ineffectiveness would seriously impair, if not destroy, the dual regulatory scheme set forth under the NGA.

Appellant's assertion that the Commission's order is pre-empted as a result of FERC's exclusive abandonment authority is specious. Abandonment requires a finding of reserve depletion by FERC. Until FERC makes such a finding, this Court is without a factual basis upon which to consider abandonment. Moreover, appellant's assertion of *de facto* abandonment is not supported by law and is based upon appellant's own conclusion as to the purpose and effect of the Commission's order.

II.

The Commission's order amending paragraph (p) does not violate the Commerce Clause of the United States Constitution. The order pertains only to matters within the exclusive jurisdiction of the Commission.

The order is designed to bring the Hugoton Gas Field into balance, thereby protecting the correlative rights of all producers in the field. A balanced reservoir also minimizes waste of natural gas ensuring that all wells enjoy a longer productive life. Likewise, consumers within and without the State of Kansas will continue to benefit from ongoing production of the lowest cost gas in the nation.

The Commission's order does not create an impermissible burden on interstate commerce. The scope of the order is confined to production and gathering activities within the State of Kansas. The order makes no requirement on either producer or purchaser. Any impact on interstate commerce is indirect and incidental. The order regulates evenhandedly because it applies to all producers in the field. The order employs the only viable conservation measure available to the Commission. No other alternative of lesser impact exists for the present situation. The state interest in correcting a known conservation problem in the Hugoton Field must be held to outweigh the indirect and incidental impact allegedly borne by appellant.

ARGUMENT

I. THE COMMISSION'S ORDER AS AMENDED IS NOT PRE-EMPTED BY THE NATURAL GAS ACT.

The critical question in any pre-emption analysis is always whether Congress intended that federal regulation supersede state law. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947). Pre-emption occurs whenever Congress, through enactment of a federal statute, has expressed a clear intent to pre-empt state law, *Jones v. Rath Packing Co.*, 430 U.S. 519 (1977), when an actual conflict exists between federal and state law, *Free v. Bland*, 369 U.S. 663, (1962), or where Congress has explicitly defined the extent to which its enactments pre-empt state law, *Puerto Rico Dept. of Consumer Affairs v. Isla Petroleum*, 108 S.Ct. 1350 (1988); *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85 (1983). In the case at bar, explicit pre-emption analysis does not apply because in enacting the NGA, Congress deliberately created a dual regulatory scheme over natural gas.

In *Schneidewind v. ANR Pipeline Co.*, 108 S.Ct. 1145, 1150 (1988), the Court discussed circumstances when a state regulation that is not explicitly barred by federal law may nevertheless be pre-empted. Such circumstances arise whenever Congress implicitly indicates "an intent to occupy a given field" leaving no room for the state law. *Rice v. Santa Fe Elevator Corp., supra* at 230. When Congress has not completely displaced state regulation in a given field, pre-emption may still apply if "'it is impossible to comply with both state and federal law, *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-143 (1963), or where the state law stands as an obstacle

to the accomplishment of the full purpose and objective of Congress, *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).'" (Citations omitted) *Schneidewind*, 108 S.Ct. at 1151.

A. The Commission's Order Does Not Encroach Upon Fields Occupied by the Federal Government to the Exclusion of State Law.

In *Schneidewind*, the State of Michigan statutorily required the approval of its public service commission before an interstate pipeline company could issue securities for capitalization of its facilities. This Court held the act was pre-empted because it regulated in a field the NGA occupies to the exclusion of state law. *Id.* at 1156. In particular, the Court focused on the fact state action imposed requirements on pipeline companies in a subject matter area already completely overseen by FERC under the NGA. In light of the state's inability to show any other legitimate reason for its action, this Court nullified the state regulation.

The purposeful creation of the dual regulatory scheme and the Commission's strict adherence to its designated field of regulation prevents its order from encroaching upon areas occupied by the federal law to the exclusion of state law. The dual regulatory scheme reserves to the states the exclusive authority over production and gathering of natural gas. 15 U.S.C. § 717(b). Nothing in the later enacted Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.*, can be construed to alter the dual regulatory scheme. The Commission order amending paragraph (p) falls squarely within the production and gathering exemption of the NGA. The order is directed solely at producers and pertains to the matter of allowables. The assignment of allowables and the subsequent cancellation

of a producer's accumulated underage are subject matters entirely within the jurisdiction served to the states. *See Northern* discussion, *supra* at 5.

In the case at hand, the Kansas Supreme Court twice stated, "The state has regulatory authority over production. The rules on underages are part of production and thus are not violative of the federal act . . ." JS App. at 10a, 41a.

B. The Commission's Order Does Not Conflict With Federal Law.

The order in the present case is distinguishable from the leading decisions of *Northern* and *Transco* upon the following bases. The order is directed at producers who receive allowable assignments. Allowable underages are therefore accrued and owned by the producer. Thus, it is the producer who must reinstate the underage or suffer permanent cancellation. The order is unequivocally silent in directing, requiring or ordering any purchaser to take gas from the Hugoton against its will. JS App. at 87a.

In *Northern*, this Court struck down state orders upon a finding that the orders conflicted with the uniformity of the federal scheme because the orders were directed at interstate purchasers and required a taking of gas. The *Northern* Court stated "the danger of interference with the federal scheme arises because these orders are unmistakably and unambiguously directed at purchasers who take gas in Kansas for resale after transportation in interstate commerce." *Northern*, 372 U.S. at 92. The Court added that, "any readjustment of purchasing patterns which such orders might *require of purchasers* who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States." *Id.* (emphasis added). Consequently, the state orders were struck down because they necessarily dealt with "matters which directly affect the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sale of natural gas and to achieve the uniformity of regulation which was an objective of the Natural Gas Act." *Id.* at 91, 92. In the final analysis, the Kansas Commission's orders set the stage for an inevitable collision between state and federal government. The Court was compelled to strike the orders down to "assure the effectuation of the comprehensive federal regulation ordained by Congress." *Id.* at 92.

Transco dealt with a similar state order requiring interstate purchasers to take ratably. The gas involved there was "high cost" gas, which was no longer directly regulated by the federal government. This Court struck down the order, thus extending *Northern* to a field not specifically occupied by the federal government, but where uniformity of the federal scheme to regulate costs and transportation might be disrupted. *Transco*, 474 U.S. at 422, 423.

The Commission's order amending paragraph (p), unlike the orders in *Northern* and *Transco*, poses no threat of collision between state and federal regulation. The order is a legitimate conservation measure properly directed at producers. The order requires no action on the part of either producers or purchasers, thereby creating no possibility of collision between state and federal gov-

ernments. By encouraging rather than ordering the timely production of allowables, the state's conservation scheme has already given way to the federal scheme.

The Kansas Supreme Court correctly distinguished *Northern* from the case at bar on two separate occasions. JS App. at 1a, 13a. The court also distinguished *Transco* on specific remand for consideration of the matter in light of this Court's decision in *Transco*. JS App. at 13a. Appellee now urges the affirmative of the distinctions drawn by the Kansas Supreme Court.

C. State Conservation Authority After Northern.

This case warrants careful scrutiny of the impact *Northern* continues to play in the natural gas industry. The Commission's order, while distinct from the orders struck down in *Northern*, must still be examined in light of the restrictions *Northern* places on the state's conservation authority. Upon examination, the amendment to paragraph (p) is clearly the only viable conservation measure employable by the state.

The predicament confronting the Commission left no viable measure to correct the drainage problem except to encourage production. Production takes from a field are often completely controlled by interstate purchasers. *Northern*, however, clearly prohibits states from ordering interstate purchasers to take gas ratably. Consequently, the practice of conservation is often disrupted by the interstate purchasers over which states have

no jurisdiction.[13] Hugoton wells continue to remain shut-in at the discretion of the pipelines. When wells are shut-in for extended periods of time, uncompensated drainage and violations of correlative rights occur. To end uncompensated drainage, the Commission must encourage production for, regardless of where the Commission sets allowables, a well will suffer drainage unless it produces. Because some Hugoton purchasers were just not taking the gas, even assuming the Commission had set market demand allowables at or below the true market demand for the years preceding 1983, the field would still have become imbalanced. *See* n. 10 at 13, *supra*.

The increasingly imbalanced field presented an ongoing violation of correlative rights. Its statutory duty to prevent "cognizable drainage" compelled the Commission to tighten the tolerance provisions of the Hugoton Basic Proration Order. After amendment, paragraph (p) better protects correlative rights in two ways. First, permanent cancellation of underages prevents producers from "banking" a proportionately greater amount of allowables. Second, the change in policy will encourage more timely production of allowables, thereby improving the overall balance of the field.

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[13] Some scholars argue that the matter now before the Court provides an opportunity for the Court to revisit Northern and its progeny for the purpose of easing the constraints placed upon the state's conservation authority. See Pierce, *The New Federalism of Natural Gas Regulation*, 4 Oil & Gas Tax 87 (1988), and Martin, *Regulation of Gas Production Rates and Imbalances After Transco v. Oil and Gas Board*, 27 Washburn L.J. 298 (1988). Appellee does not advocate such a ruling as absolutely necessary. Rather, appellee seeks simply to apprise the Court of possible dangers arising from further erosion of state authority.

As a result of the *Northern* holding, permanent cancellation of underages is the state's only alternative to prevent waste and protect correlative rights. The Commission has acted exactly as the *Northern* Court advised.[14] The policy does not *force* the pipeline purchasers to take any action. The policy ecourages production because production is the only method of obtaining compensating drainage. By changing policy to encourage timely production of allowable assignments, the Commission took the only available action permitted by law.

The *Northern* Court noted that invalidation of state regulation could create a possible regulatory "gap" which the NGA was designed to prevent. *Northern*, 372 U.S. at 95. The possibility of this gap looms even larger in the case at hand. If a state can no longer enforce its allowable assignments then the concept of restrictive production as a conservation tool becomes meaningless. The pipeline purchasing companies will then effectively control the field and cancelled underage will become tantamount to a vested interest contractually owned by the purchasers. The NGA was designed in part to prevent the possibility of such monopsony and oligopsony.

D. The Order Does Not Constitute Abandoment of Reserves Dedicated to Interstate Commerce.

Congress expressly made abandonment of natural gas facilities subject to the NGA and service from such facili-

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[14] "The State does not appear to be without alternative means of checking waste and disproportionate or discriminatory taking." *Northern* 372 U.S. at 94. The Court suggested, "proration and similar orders *directed at producers*," as regulatory alternatives. *Id.* n. 12 (emphasis added).

ties a matter of federal jurisdiction. Section 7(b), 15 U.S.C. § 717f(b). Congress authorized FERC to control the manner in which abandonment of facilities and service occurs. The plain language of the statute states abandonment cannot occur "without the approval and permission of the [FERC] Commission" who must make a finding that, "the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment." 15 U.S.C. § 717f(b). The statutory requirement for FERC approval of abandonment of facilities or services is without exception. *United Gas Pipeline Co. v. McCombs*, 442 U.S. 529, 537, (1979) (citing *United Gas Pipeline v. FPC*, 385 U.S. 83, 89 (1966)). Once gas is dedicated to interstate commerce, it cannot be withdrawn from continued interstate movement without FERC approval. *Atlantic Refining Co. v. Public Service Comm'n.*, 360 U.S. 378, 388 (1959); *see also California v. Southland Royalty Co.*, 436 U.S. 519, 523-527 (1978).

For the first time in these proceedings, appellant raises before this Court the argument that the Kansas Commission's amendment to paragraph (p) constitutes *de facto* abandonment. In so doing, appellant attempts to avoid the statutory exclusivity FERC maintains over the determination of abandonment. Only FERC can make the statutory finding that abandonment of facilities or service has occurred. FERC has made no such finding in this case. This Court is without a factual basis to review appellant's contention of abandonment.

Should this Court decide to review the Commission's order on the abandonment issue, it should find the Com-

mission's order does not constitute abandonment of interstate reserves. Abandonment of service within the meaning of the NGA requires a permanent reduction of a significant portion of a particular service. *United Gas Pipeline*, 385 U.S. at 86-88. The prohibition against abandonment without FERC approval ensures that FERC controls the conditions under which service will cease. *Southland Royalty*, 436 U.S. at 524. Once gas begins to flow in interstate commerce, the flow cannot be terminated unless FERC authorizes abandonment. *Id.* at 527. However, no case has been found extending FERC jurisdiction directly into the physical activities, process, and facilities of production and development. *Shell Oil Co. v. Federal Energy Reg. Comm'n.*, 566 F.2d 536, 540 (5th Cir., 1978) (holding FERC's regulation requiring producers to be "prudent operators" in developing and maintaining deliverability from natural gas reserves encroaches on areas reserved to the states).

The Commission's order cancelling accrued underages will not cause a permanent reduction in service because it is designed to balance drainage in the Hugoton field and to protect reserves for when shut-in wells begin to produce. Allowables are continuously reassigned under the Commission's formula which factors in deliverability. *See* n. 10 at 13, *supra*. The deliverability factor ensures that shut-in wells receive proportionately higher allowables as long as they remain shut-in. Once these wells begin to produce, their higher allowable assignment will ensure that gas migrates allowing them to produce their fair share of reserves. Thus, no permanent reduction in service to the consumer occurs.

II. THE COMMISSION'S ORDER AMENDING PARAGRAPH (p) OF THE BASIC PRORATION ORDER FOR THE HUGOTON GAS FIELD DOES NOT CONSTITUTE AN IMPERMISSIBLE BURDEN UPON INTERSTATE COMMERCE IN VIOLATION OF THE COMMERCE CLAUSE.

In *Brown-Forman Distillers Corporation v. New York State Liquor Auth.*, 476 U.S. 573, 579 (1986), this Court set forth the following two-tiered approach for analyzing state economic regulation under the Commerce Clause:

> When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state economic interests, we have generally struck down the statute without further inquiry. See, *e.g.*, *Philadelphia v. New Jersey*, 437 U.S. 617, 98 S.Ct. 2531, 57 L.Ed.2d 475 (1978); *Shafer v. Farmers Grain Co.*, 268 U.S. 189, 45 S.Ct. 481, 69 L.Ed. 909 (1925); *Edgar v. MITE Corp.*, 457 U.S. 624, 640-643, 102 S.Ct. 2629, 2639-41, 73 L.Ed.2d 269 (1982) (plurality opinion). When, however, a statute has only indirect effects on interstate commerce and regulates evenhandedly, we have examined whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970). We have also recognized that there is no clear line separating the category of state regulation that is virtually *per se* invalid under the Commerce Clause, and the category subject to the *Pike v. Bruce Church* balancing approach. In either situation the critical consideration is the overall effect of the statute on both local and interstate activity. See *Raymond Motor Transportation, Inc. v. Rice*, 434 U.S. 429, 440-441, 98 S.Ct. 787, 793-94, 54 L.Ed.2d 664 (1978).

A. The Commission's Order Does Not Promote Economic Protectionism for the State of Kansas.

The appellant cites evidence in the record indicating a large number of wells have consistently produced their allowables into intrastate markets. Many of these wells are located near shut-in wells, which are connected to interstate pipelines. Appellant argues that by permanently cancelling underages, the Commission's order denies the underproduced wells the opportunity to offset any drainage which might have occurred toward the intrastate-bound wells. Appellant alleges this is a discriminatory diversion of the low-cost Hugoton gas into the Kansas market and therefore constitutes economic protectionism. Appellant's argument is premised upon propositions which cannot stand in the face of the record.

Evidence at the hearing demonstrated, and the Commission found, that drainage was already occurring at a rate that was violating correlative rights and causing waste. The Commission's order is designed to stop the drainage which, by reason of its argument, appellant must concede is occurring. Additionally, a producer's opportunity to obtain compensating drainage is not impaired by the permanent cancellation of underages. Allowables will continue to be assigned to the well based on deliverability pressure. Underproduced wells will continue to receive higher allowable assignments because of higher pressure. Toward that end, the Commission's order will also ensure shut-in wells do not gain an unfair advantage by "banking" higher allowables and reserves are not prematurely depleted. As noted in example (1), *supra* at 12, this practice disrupts the proportionality of allowable assignments over time. A shut-in well could gain an unfair advantage by receiving higher allowable assignments over the same period of time that adjacent wells are producing because the adjacent wells will be dropping off in deliverability pressure. On the other hand, if the shut-in well is not produced in a timely manner, the underlying reserves may be drained away with no chance for compensating drainage before the end of the life of the field. See example (2), *supra* at 14. In such a case, all of the allowable assignments in the world would be useless. The Commission's order is designed to prevent this from taking place.

The Commission's order protects the rights of all producers in the field regardless of the destination of a specific well's gas. This evenhanded regulation promulgated for the sole purpose of correcting the drainage problem, caused in large part by the purchasing practices of interstate purchasers, cannot be said to constitute economic protectionism.

The fact that appellant disagrees with the conclusions reached by the Commission does not enable appellant to substitute its judgment as support for its propositions here. Regulation of the Hugoton Field requires the Commission to sort through vast, dynamic and complex issues applying principles of geology, petroleum engineering and law. On appeal, the Kansas Supreme Court twice examined and affirmed the Commission's order holding that it was adequately supported by substantial competent evidence. JS App. at 11a-12a, 36a-37a.

B. The Order Does Not Constitute an Impermissible Burden Upon Interstate Commerce.

Absent a finding of economic protectionism, the interest of the state action is then balanced against any

burden it imposes on interstate commerce. *Pike*, 397 U.S. at 142.

The Commission's order has no direct effect on interstate commerce. The order is directed at producers operating within the boundaries of the Kansas Hugoton Field. The order cancels accrued underages from Commission records thereby removing the producer's right to produce *that specific allowable*. The order does not affect a producer's right to produce its underlying reserves, but simply limits the time within which the producer may produce a given allowable. The order acts to preserve the reservoir and ensure that each well produces only its fair share of underlying reserves. The order requires nothing of the producer but does encourage the timely production of allowables. Moreover, the passive producer is not penalized, nor is the active producer given an advantage by its production.

The order requires nothing of the purchaser. If, in view of the pending permanent cancellation of some underages, a purchaser and producer choose to reinstate and produce the underages, they are free to do so. The Commission encourages production because production is the only way to protect correlative rights and prevent waste. Whether the Commission's order affects interstate purchasers depends on their purchasing decisions. Consequently, the absence of a directive requiring action on the part of the purchasers makes any effect upon interstate commerce indirect and inconclusive.

Because the Commission's order has no direct effect on interstate commerce, the *Pike v. Bruce Church* test is applicable. When a statute only indirectly affects interstate commerce and regulates evenhandedly, the Court examines whether the state's interest is legitimate, whether the burden on interstate commerce clearly exceeds the local benefits and whether an alternative of lesser impact is available. *Pike v. Bruce Church*, 397 U.S. at 142. The application of the *Pike v. Bruce Church* test leads undeniably to the conclusion the amendment to paragraph (p) does not unconstitutionally burden interstate commerce.

1. The Order regulates evenhandedly because it applies to all producers in the field. No single producer is given an advantage by operation of the order. The order checks the disruptive forces which drainage imparts upon both shut-in and producing wells. The objective of the order is to enhance the equitable and proportionate production from all wells with comparable reserve characteristics.

2. The order is a legitimate exercise of the state's authority to prorate production of natural gas. Prorationing serves the legitimate state interest of protecting correlative rights and preventing waste. These very conservation interests prompted the creation of the dual regulatory scheme by Congress. JS App. at 66a-79a, 84a-91a.

3. Any impact on interstate commerce resulting from the Commission's order is not unduly burdensome, but incidental, in light of the local interest promoted by the state action. Because neither purchasers nor producers are compelled to act, it is inconclusive whether the order will have any impact on interstate commerce. Prior to determining whether the threat of cancellation will affect interstate commerce, it is necessary to scrutinize the appellant's basic presumption.

Appellant's entire appeal is based upon the presumption that cancelled underages belong to the purchaser and the Commission has no authority to permanently cancel such underages. The appellant is even so bold as to state, "[C]onsequently, interstate pipelines accumulated huge underages." Appellant's Brief at 9. Nothing could be further from the truth. Allowables have never been assigned directly to the pipeline purchasers. Allowables are assigned to producers. Underages accrue to the well in the name of the producer.

If appellant, by virtue of a contract with its producer, does have an interest in taking the producer's underages, appellant may want the producer to reinstate cancelled underages before they are permanently cancelled. However, appellant must now make this decision within the time constraints set forth by the Commission.

The fact appellant must decide whether to purchase Hugoton gas more quickly than it had planned is its basis for asserting excessive burden upon interstate commerce. It must be re-emphasized that the state is not ordering appellant to purchase Hugoton gas; that decision has always been left to the appellant. The issue therefore becomes, *if* appellant desires to purchase cancelled underage, is it an excessive burden upon interstate commerce for appellant to make the decision before the end of eight years?[15] The answer must be in the negative.

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[15] The vintage provisions of paragraph (p) will eventually allow a three-year time limit for reinstatement and five years to produce reinstated underage. The current vintage period has twice been extended by further orders amending paragraph (p) so that upon its expiration date of December 31,

(Continued on following page)

The state's interest in conservation should not give way to the purchasing deliberations of appellant. The Commission must be allowed to function reasonably in protecting correlative rights and mitigating waste without catering to varying, even conflicting decisions, by interstate purchasers.

The fact that the Commission's order may affect the pipelines purchasing decisions does not render the order burdensome to interstate commerce. As stated by this Court in *Exxon Corporation v. Governor of Maryland*, 437 U.S. 117, 126 (1978), "The fact that the burden of a state regulation falls upon some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." Appellant has failed to demonstrate that any impact imposed by the Commission's order outweighs the state conservation interests.

4. The state's interest could not be promoted by an alternative of lesser impact. The Commission determined the source of the correlative rights problem was drainage caused by shut-in wells and not the setting of allowables. J.S. App. at 73a. The Commission further determined the tolerance provisions of paragraph (p) provided no incentive for the timely production of allowables.

(Continued from previous page)

1989, operators will have been given seven years to reinstate cancelled underage accrued before January 1, 1987. Operators also have the standard five years in which to produce this underage, thereby providing a total of twelve years for the current vintage period. Additionally, the Commission's orders remove specific restrictions placed on procedures applying for reinstatement. These restrictions were removed to enhance the producer's ability to participate in the open "spot" market thereby complimenting current policy objectives of FERC. See Appendix C at 15a.

Therefore, the Commission implemented its policy of permanently cancelling underages.

The Commission has always maintained plenary authority over the setting and cancellation of allowables. Cancelled underages cannot be produced until the producer's application to reinstate the underages is approved by the Commission. Upon reinstatement, the underages must be produced within an established length of time. A prior version of paragraph (p) contained a similar time restriction as it conditioned reinstatement upon a showing "that the length of time . . . for the production of the amounts of gas to be reinstated is reasonable under the circumstances." J.A. at 24. The Commission has always possessed authority to limit production of assigned allowables. The Commission could have simply implemented its new policy by separately denying each application for reinstatement. Such a well-by-well implementation of policy could only lead to further aggravation of the field's imbalance and, therefore, was not a viable alternative. Thus the Commission implemented its change in policy on a non-discriminatory field-wide basis through amendment of the basic order.

The Commission's authority to adopt an amendment allowing for permanent cancellation of underages was upheld by the Kansas Supreme Court in *Republic Natural Gas Co. v. State Corporation Commission*, 173 Kan. 172, 244 P.2d 1196 (1952). Responding to challenges of the Commission's authority to cancel underages, the Court

stated, "[T]here is nothing hard and fast, unreasonable or arbitrary about the cancellation of underages." *Id.* at 181. The Court added, "[T]he entire matter, not of the cancellation, but of what effect the cancellation shall have on the future production of any well is a matter addressed to the judgment and discretion of the Commission after a hearing." *Id.*

In the final analysis, appellant's appeal is based upon nothing more than its frustration with the Commission's change in policy. Appellant is no longer afforded the luxury of counting on its connected producers in Hugoton to bank underages indefinitely.

Appellant cannot argue unfair surprise in the Commission's change of policy. Appellant was aware the Commission possessed authority to limit reinstatement of underages. In fact, on numerous occasions the Commission has amended paragraph (p) to protect the reservoir from imbalanced drainage. On rehearing, the Commission stated:

> It has been pointed out numerous times that this Commission has amended various provisions of the Hugoton Basic Order including paragraph (p) to meet the changing conditions of the field. Such changes have been upheld by the courts as being within the Commission's authority. In issuing the February 16th order, the Commission is once again making amendments to its order to address the current situation in the field. JS App. at 91a.

Appellant must not be allowed to allege excessive burden by reason of its personal disgruntlement. As the dissent in *Transco* states, "A party runs the risk, of reasonably foreseeable application of new principles of state law to its activities, see *Energy Reserves Group, Inc. v.*

Kansas Power & Light Co., 459 U.S. 400 (1983), and that is the most that can be said to have happened here." *Transco* at 434, 435.

CONCLUSION

For the foregoing reasons, the judgment of the Kansas Supreme Court should be affirmed.

Respectfully submitted,

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APPENDIX A

NATURAL GAS ACT

SECTION 7
15 U.S.C. § 717f

EXTENSION OF FACILITIES; ABANDONMENT OF SERVICE

(a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: Provided, That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained after due hearing, and a finding by the Commission that the available supply of

natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c)(1)(A) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate for public convenience and necessity issued by the Commission authorizing such acts or operations: Provided, however, that if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

(B) In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereof to all interested persons as in its judgment may be necessary under rules and regulations to be

prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: Provided, however, That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(2) The Commission may issue a certificate of public convenience and necessity to a natural-gas company for the transportation in interstate commerce of natural gas used by any person for one or more high-priority uses, as defined, by rule, by the Commission, in the case of—

(A) natural gas sold by the producer to such person; and

(B) natural gas produced by such person.

(d) Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form; contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation, require.

(e) Except in the cases governed by the provisos contained in subsection (c)(1) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and will-

ing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

(f) The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which eacch authorization under this section is to be limited. Within such service area as determined by the Commission a natural-gas company may enlarge or extend its facilities for the purpose of supplying increased market demands in such service area without further authorization.

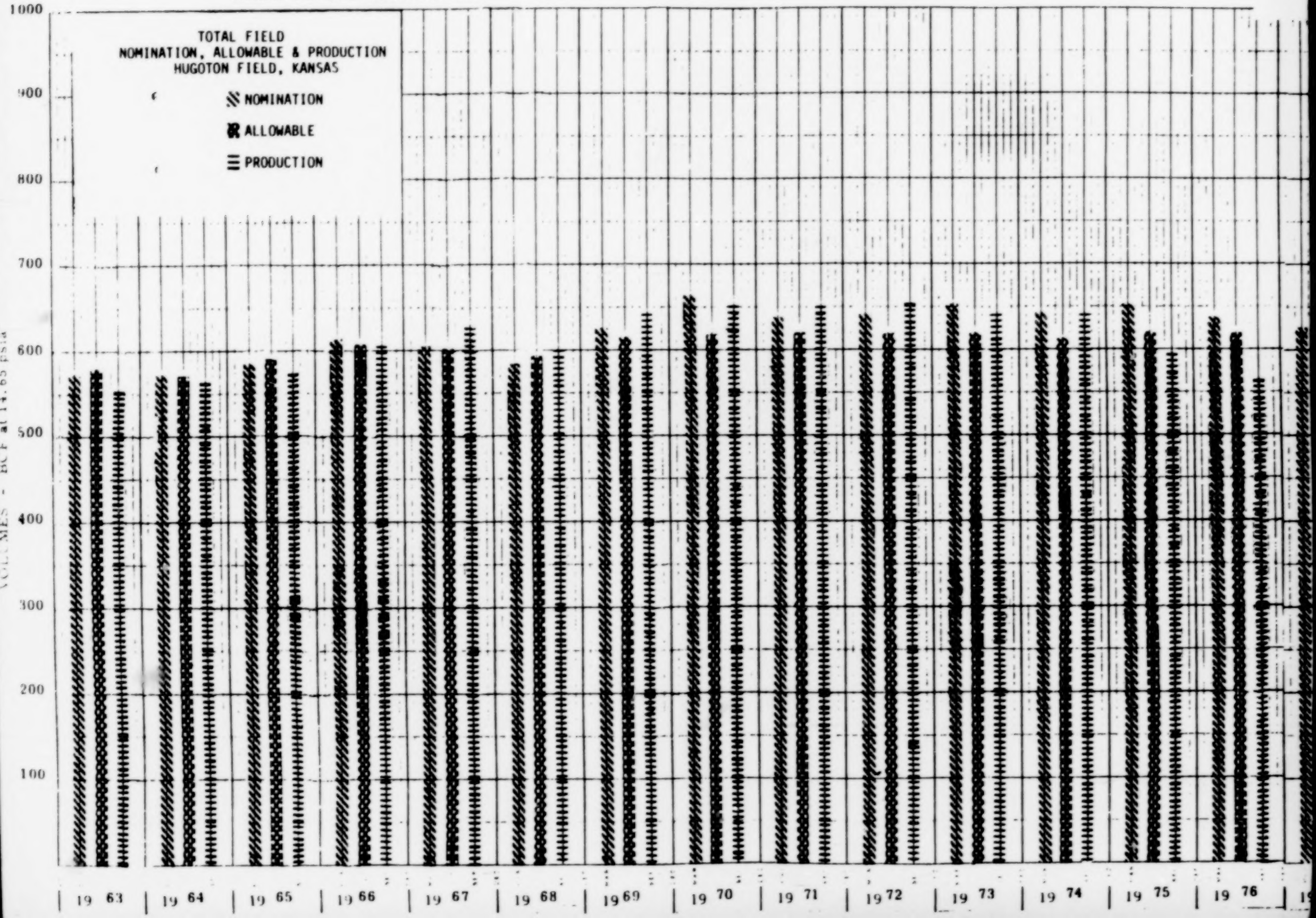
(g) Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company.

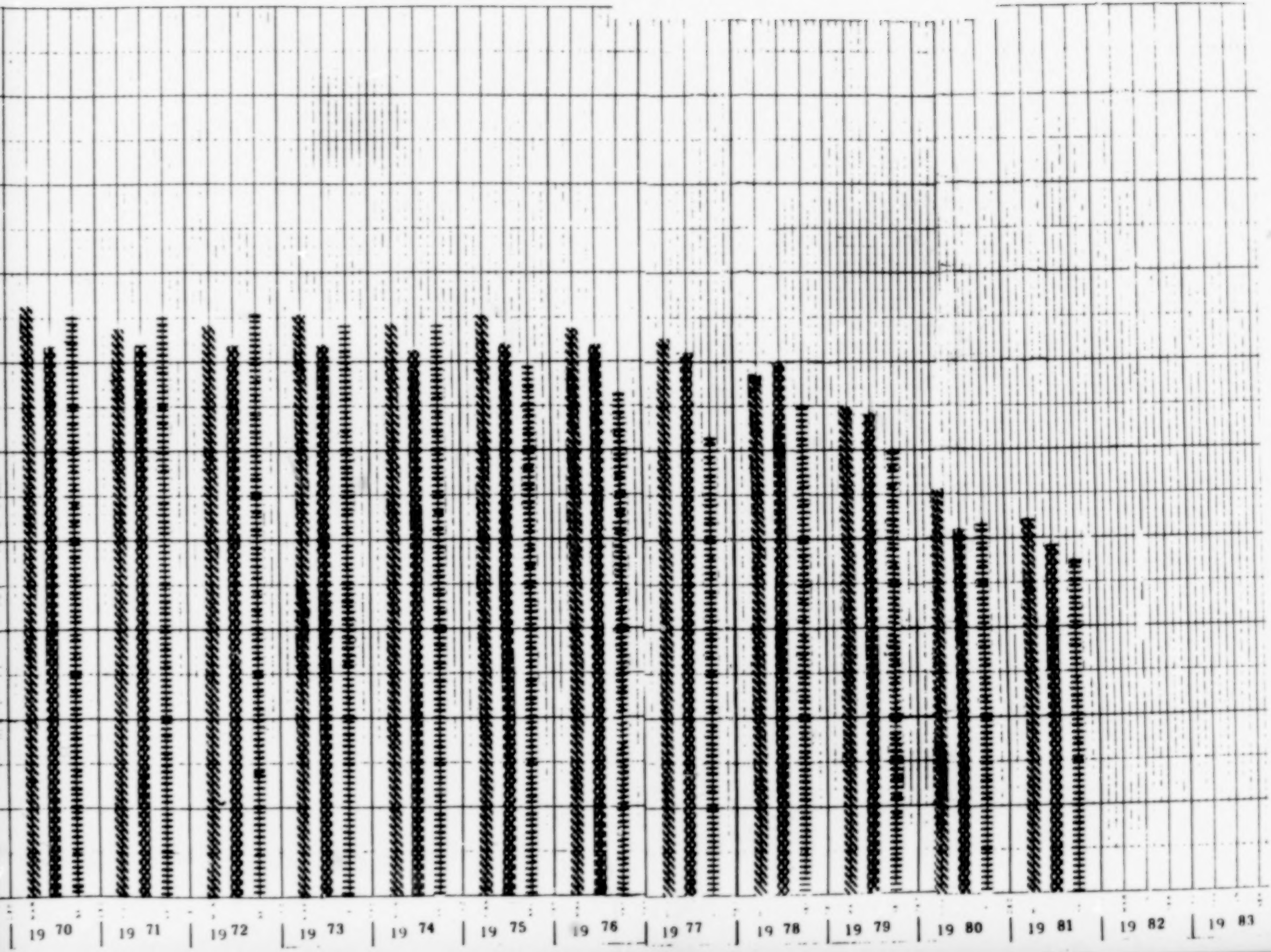
(h) When any holder of a certificate of public convenience and necessity cannot acquire by contract or is unable to agree with the owner of property to the compensation to be paid for, the necessary right-of-way to construct, operate, and maintain a pipe line or pipe lines for the

transportation of natural gas, and the necessary land or other property, in addition to right-of-way, for the location of compressor stations, pressure apparatus, or other stations or equipment necessary to the proper operation of such pipe line or pipe lines, it may acquire the same by the exercise of the right of eminent domain in the district court of the United States for the district in which such property may be located, or in the State courts. The practice and procedure in any action or proceeding for that purpose in the district court of the United States shall conform as nearly as may be with the practice and procedure in similar action or proceeding in the courts of the State where the property is situated: Provided, That the United States district courts shall only have jurisdiction of cases when the amount claimed by the owner of the property to be condemned exceeds $3,000.

APPENDIX B

Exhibit No. 17 Docket No. C-164

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APPENDIX C

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Keith R. Henley, Chairman
Rich Kowalewski
Margalee Wright

In the Matter of the Application of	)	DOCKET NO.
MESA OPERATING LIMITED	)	C-164
PARTNERSHIP for an Order	)	
Amending Paragraph (p) of the	)	
Basic Proration Order for the	)	CONSERVA-
Hugoton Gas Field to permit the	)	TION
Reinstaterement of Cancelled	)	DIVISION
Underages without the well being	)	
in a current overproduced status.	)	LICENSE
	)	NO. 4824

ORDER

Now, the above-captioned matter comes on for consideration and determination before the State Corporation Commission of the State of Kansas upon the application of Mesa Operating Limited Partnership for an order amending paragraph (p) of the Basic Proration Order for the Hugoton Gas Field.

On May 29, 1987, Mesa Operating Limited Partnership, (Mesa), filed the above-referenced application now before the Commission for consideration. The application requests that the Commission issue an order amending paragraph (p) of the Basic Proration Order for the Hugoton Gas Field by eliminating the requirement that a well be in a net overproduced status before requesting reinstatement of cancelled underages. Additionally, the application requests that the present paragraph (p) be amended

to permit operators to apply for reinstatement of concelled underages without having to state the name of a purchaser.

Notice of the application was published in the Wichita Eagle-Beacon as well as each of the county newspapers for the following counties: Kearny, Finney, Grant, Haskell, Morton, Stevens, Seward, Stanton, Gray, Wichita and Hamilton Counties, all in Southwest Kansas. The notice stated that the matter would be taken up before the Commission at its regular monthly docket in the Conservation Division Hearing Room, 300 Colorado Derby Building, 202 West First Street, Wichita, Kansas, on July 30, 1987, beginning at 9:00 a.m. or as soon thereafter as may be reached.

The matter was heard as noticed by the Commission on July 30, 1987. The following appearances were entered: Richard C. Byrd, Ottawa, Kansas, and Gary Prescott, Amarillo, Texas, appeared on behalf of Mesa Operating Limited Partnership. Richard C. Byrd also appeared on behalf of Tenneco Oil Company. Steven D. Gough, Wichita, Kansas, appeared on behalf of Amoco Production Company. Ralph R. Brock, Wichita, Kansas, appeared on behalf of Graham-Michaelis Corporation, Ensign Operating Company, Kansas Petroleum Inc. and Cabot Petroleum Corporation. Stanford Smith, Wichita, Kansas, appeared on behalf of Cities Service Oil and Gas Corporation. Timothy McKee, Wichita, Kansas, appeared on behalf of Helmerich & Payne, Inc. and Colorado Interstate Gas Company. Also appearing on behalf of Colorado Interstate Gas Company was Charles Jordan of Colorado Springs. Jack Glaves, Wichita, Kansas, appeared on behalf of Panhandle Eastern Pipeline Company. Jerome E. Jones, Wichita, Kansas, appeared on behalf of Mobil Oil Corporation and Anadarko Petroleum Corporation. Kurt Clausing and Charles Hoke, Wichita, Kansas, appeared on behalf of Petroleum Production Management, and Doug Pringle, Wichita, Kansas, appeared on behalf of K N Energy. James E. Browne, Assistant General Counsel, appeared on behalf of the Commission staff and the public generally. There were no other appearances.

The Commission, being fully advised of the premises and having given due consideration to its records and files and all evidence related thereto, makes the following finds and conclusions:

1. The application in this docket was filed pursuant to the rules and regulations of the Commission and the Kansas Statutes, thus fulfilling all regulatory and statutory requirements.

2. Notice was proper in every respect and was published as required by law at least ten (10) days prior to the hearing.

3. The Commission has been given jurisdiction to regulate the production of natural gas from a common source of supply in order to insure the orderly development of and production of natural gas pursuant to K.S.A. 55-703.

4. Whenever the available production from the common source of supply is in excess of the market demand and the Commission has experienced its jurisdiction over the common source of supply, a producer is allowed to produce only a portion of the gas that may be produced without waste and to satisfy the market demand and to currently produce proportionately with other developed

leases. The Basic Proration Order for the Hugoton Gas Field was first adopted on March 21, 1944. As part of the Basic Proration Order a deliverability formula was established for the use of assigning allowable to the wells producing from the Kansas Hugoton Field. To allow some flexibility to the producers in the field, the Commission established production tolerances for over and underproduction of the allowable as set by the Commission as a part of the market demand proceedings. The tolerance provisions are set forth in paragraph (p) of the Basic Order.

5. On February 16, 1983, the Commission issued an order amending paragraph (p) of the Basic Order. At that time the Commission found that the field was coming out of balance due to non-uniform drainage created by accumulating underages. The Commission further found that it was desirable to increase reinstatement and production of cancelled underages because such an increase would protect correlative rights. The Commission therefore set forth the parameters within which cancelled underage must be reinstated or permanetnly cancelled.

6. The Commission finds that the Order issued February 16, 1983, and its policy objectives remain valid today and should not be changed or diminished in any manner. The application in the matter at hand must therefore be determined in light of the 1983 amendments to paragraph (p). Proponents of the application argue that the proposed amendments are conducive to the goals of the 1983 amendments. Opponents of the application argue that it does not present sound conservation policy or, in the alternative, that the burdensome side effects of the application outweigh any benefits. Testimony and exhibits in

support of the application were presented by Mesa and Amoco Production Company (Amoco). Cities Service Oil and Gas Company (Cities) and Graham-Michaelis Corporation presented evidence in opposition to the application.

7. Sam A. Giovinco, Jr. reservoir engineer for Mesa, appeared in support of the application. Mr. Giovinco testified that the current paragraph (p) inhibits reinstatement of cancelled underages by requiring that wells be in a net overproduced status prior to reapplying for reinstatement. Mr. Giovinco presented exhibits which showed that Mesa, as well as other producers in the Hugoton Field, will not be able to get their wells into a net overproduced status by the time the September 30, 1987, deadline arrives. However, if the wells were allowed to reinstate the underage, they could make up most if not all of their cancelled underage within the allotted 60 month period.

8. The requirement that wells be in a net overproduced status was made a part of the Basic Order in 1975. Mr. Giovinco testified that the purpose of the requirement was to insure that the well was capable of producing the cancelled underages sought to be reinstated. Contrary to this however, Mr. Giovinco's testimony indicated that the overproduced status requirement is not serving the purpose for which it was intended and in fact may be prohibitive to the reinstatement of production of cancelled underages.

9. Mr. Giovinco next testified to the second request in Mesa's application. There, Mesa requests that paragraph (p) be amended to permit applications for the reinstatement of cancelled underage without the application

stating the name of the purchaser. Specifically, Mesa requests that instead of petitioning to show that *the* purchaser is ready and willing to purchase gas, an applicant will simply need to show that *a* purchaser is ready and willing to purchase gas. The record clearly indicates that Mesa intends for this change to circumvent the phrase 'ready and willing'. The effect of the change will render null the requirement that a producer have a ready and willing purchaser at the time of filing for reinstatement of cancelled underage. Staff therefore recommended that additional changes be made to reflect the true intent of the proposed amendment. Mr. Giovinco testified that the changes are recommended by Mesa because with the recent changes in the marketing of natural gas, an operator may not know who the purchaser will be when they file the application for reinstatement. Mesa is advocating its change in order to help facilitate spot market purchases. If its application is granted Mesa believes that producers will reinstate large amounts of cancelled underage and then seek purchasers for the reinstated gas. This is consistent with the objectives of the 1983 amendments.

10. Richard Ruggiero, petroleum engineer, testified in further support of the application. Mr. Ruggiero testified that because of FERC Orders 436 and 451, it does not make sense to condition the reinstatement of underage to the ability of one company to take the gas when the reality is that it may be sold to other parties. Mr. Ruggiero's testimony indicated that the changes requested by Mesa will enhance participation in the spot market. Mr. Ruggiero also stated that the current provisions of paragraph (p) are prohibitive to such participation in the market place. The Commission's recently implemented procedural orders which require monthly docket applications to be

filed nearly two months before hearing would inhibit such spot sales if the current paragraph (p) provisions are not amended. In summary, both Mesa and Amoco presented substantial evidence which showed that the proposed amendments are very likely to increase the reinstatement and consequently the production of cancelled underages.

11. Lester Wilkonson, consulting petroleum engineer, testified in opposition to the application on behalf of a group of independent producers. Mr. Wilkonson presented testimony and exhibits in support of his alternative recommendation which is a two-prong proposal. First, he recommends that the Commission extend the present moratorium for a period of five years. Second, Mr. Wilkonson recommends that all underage, cancelled and current, be combined and shown on the Hugoton Gas Field report and, in addition, that the cancellation of underage be suspended during the five year period. The Commission finds that the issue of extending the present moratorium is pending before the Commission on another docket at this time and therefore does not warrant further consideration at this time. Regarding the second proposal, such a recommendation appears to be contrary to the objectives set forth in the 1983 amendments to paragraph (p). The Commission therefore declines further consideration of such proposal.

12. Mr. Bill Bryan testified on behalf of Cities Service Oil and Gas. He raised four objections to Mesa's application. The first, the difficulty of certifying that a purchaser is ready and willing to take the gas is made moot by elimination of this requirement. In his second objection, Mr. Bryan joined Mr. Wilkonson in expressing concern that the FERC Orders cannot be applied equally to

all operators in the field. The Commission must make its determination based upon sound Conservation policy and implement all changes on a field-wide basis. Mr. Bryan next contended that the proposed changes will create an administrative and accounting nightmare for the Commission. The Commission finds that the specific problems raised by Mr. Bryan do not warrant denying the application.

13. Mr. Bryan's final objection is that the application is not in the best long term interest of orderly proration of the field. The Commission finds otherwise. The applicant has demonstrated that the changes in paragraph (p) will increase reinstatement of cancelled underages. It is anticipated that this together with changes in the natural gas market will bring about increased production of the reinstated underages. Mr. Bryan himself testified that production is what protects correlative rights. Moreover, easing the reinstatement requirements does not necessarily diminish the effectiveness of paragraph (p). All deadlines will remain in force so that timely reinstatement of cancelled underages will be required. Mesa's proposal is consistent with the current provisions of paragraph (p) and in fact will update the provisions to make them more effective in achieving the Commission's objectives.

THE COMMISSION THEREFORE FINDS THAT: The present requirement that a well must be in a net overproduced status before cancelled underages can be reinstated should be eliminated from paragraph (p). A well's current status is not indicative of the well's ability to produce cancelled underages. The Commission further finds that in light of recent changes in the national gas market,

the requirement that an application for the reinstatement of cancelled underages state that a purchaser is ready and willing to take the underages is frequently impossible and constitutes an unnecessary burden upon the applicant. The requirement should therefore be eliminated. The Commission is of the opinion that these two changes in the basic order are consistent with the purpose and objectives of the 1983 amendments and order. Once underages are reinstated, producers will have 60 months to produce the underage. This deadline will serve as further incentive for the producer to actively participate in the market. The amendments adopted will help to achieve the goals of both the FERC orders as well as the 1983 amendments to Paragraph (p).

IT IS, THEREFORE, BY THE COMMISSION ORDERED: That the above referenced application to amend Paragraph (p) of the Hugoton Basic Order, be, and the same is hereby granted and that the present requirement that a well must be in a net overproduced status before an application for the reinstatement of cancelled underages may be filed is removed from said paragraph. In addition, the requirement that applications of the reinstatement of cancelled underages must state that the purchaser is ready and willing to take the additional gas shall no longer be required.

The full text of Paragraph (p) reflecting the changes made by this order will be set forth in the Commission's order in the consolidated moratorium applications to be issued concurrently herewith.

The Commission retains jurisdiction of the subject matter and the parties for the purpose of entering such

further Order or Orders as from time to time it may deem proper.

BY THE COMMISSION IT IS SO ORDERED.

Henley, Chmn.; Kowalewski, Com.; Wright, Com.
Dated: SEP 16 1987

/s/ Judith McConnell
Judith McConnell
Executive Director

Date Mailed: SEP 21 1987

I CERTIFY THE ORIGINAL
COPY IS ON FILE WITH
The State Corporation Commission

SEP 16 1987

/s/ Judith McConnell
Executive Director

CERTIFICATE OF SERVICE

I hereby certify that on the 21st day of September, 1987, I caused a true and correct copy of the foregoing Order to be served by placing the same in the United States Mail, postage prepaid, to the following parties:

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/s/ James E. Browne
Assistant General
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Kansas Corporation
Commission

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Keith R. Henley, Chairman
Rich Kowalewski
Margalee Wright

In the matter of the application of AMOCO PRODUCTION COMPANY for an order granting a three-year moratorium within which to request reinstatement of underage cancelled between January 1, 1975, through September 30, 1984, under Paragraph (p) of the Basic Proration Order for the Hugoton Gas Field, including any necessary amendments thereto, all of which related to wells operated by Amoco Production Company and other producers in the Hugoton Gas Field in Kearny, Finney, Grant, Haskell, Morton, Stevens, Seward, Stanton, Gray, and Hamilton Counties, Kansas.	)	DOCKET NO. C-164

In the matter of the application of HELMERICH & PAYNE, INC. for an order extending from September 30, 1987, until September 30, 1988, a deadline to file applications for reinstatement under Paragraph (p) of the Basic Proration Order for the Hugoton Gas Field as applies to applicant's wells.	)	DOCKET NO. 156, 374-C (C-22,590)

In the matter of the application of GRAHAM-MICHAELIS CORPORATION for an order amending Paragraph (p) of the Basic Proration Order for the Hugoton Gas Field to extend the time to September 30, 1992, within which to apply for reinstatement of underage cancelled between January 1, 1975, and September 30, 1987, and such other amendments as may be appropriate to afford all producers a reasonable opportunity to avoid permanent cancellation of underage.	)	DOCKET NO. C-164
	)	CONSERVATION DIVISION

ORDER

Now, the above-captioned matters come on for consideration by the State Corporation Commission of the State of Kansas.

On January 29, 1986, the Commission issued an order amending paragraph (p) of the Basic Proration Order for the Hugoton Gas Field. The Order placed a moratorium upon the current tolerance deadline until September 30, 1987. Pursuant to that order, producers in the Hugoton Field have until September 30, 1987, to file applications to reinstate underage cancelled between January 1, 1975, to September 30, 1984.

On July 7, 1987, Amoco Production Company (Amoco) filed an application requesting an extension of the moratorium for a period of three years. Also on July 7, 1987, Graham-Michaelis Corporation filed an application requesting that the moratorium be extended for a period of five years. Both applications were filed under Docket No. C-164. By order of the Commission the matters were

consolidated and specially set for hearing on August 28, 1987. Also consolidated at that time was an application filed by Helmerich & Payne, Inc., requesting a one year moratorium for its wells only. At hearing, Helmerich & Payne, Inc. did not prosecute its application. The Commission therefore finds that that particular application should be summarily dismissed herein.

Notice of the hearing was published in the Wichita Eagle-Beacon newspaper and in newspapers having a general circulation in the counties comprising the Hugoton Gas Field stating that the matter would be heard on August 28, 1987, at 9:00 a.m. in the Hearing Room of the Conservation Division, Wichita, Kansas.

The matter was heard as noticed by the Commission on August 28, 1987. The following appearances were entered: Steven D. Gough and David E. Brody, Wichita, Kansas, appeared on behalf of Amoco Production Company; Timothy McKee, Wichita, Kansas, appeared on behalf of Helmerich & Payne, Inc.; Ralph R. Brock, Wichita, Kansas, appeared on behalf of Graham-Michaelis Corporation, Ensign Operating Co., Kansas Petroleum Inc. and Cabot Petroleum Corporation; Philip M. Knighton, Wichita, Kansas, appeared on behalf of Sunburst Exploration Co., Inc.; Richard C. Byrd, Ottawa, Kansas, appeared on behalf of Mesa Operating Limited Partnership; Stanford Smith, Stanford Smith, Jr., Wichita, Kansas, and John Lovett, Tulsa, Oklahoma, appeared on behalf of Cities Service Oil and Gas Corp.; David W. Nickel, Wichita, Kansas, appeared on behalf of Santa Fe Minerals; Charles E. Hoke, Wichita, Kansas, appeared on behalf of Petroleum Production Management, Inc.; Jerome E.

Jones, Wichita, Kansas, appeared on behalf of Mobil Oil Corp. and Anadarko Petroleum Corporation; Kay Gowen, Mark H. Adams and J.D. Steelman, Wichita, Kansas, appeared on behalf of Williams Natural Gas Company; Kay Gowen and Mark Adams appeared on behalf of Northern Natural Gas, a Division of Enron Corporation; Jeff Kennedy, Wichita, Kansas, appeared on behalf of K N Energy, Inc.; Jack Glaves, Wichita, Kansas, appeared on behalf of Panhandle Eastern Pipeline Co.; and James E. Browne appeared on behalf of the Commission staff and the public generally. There were no other apperances.

The Commission, being fully advised in the premises, and having consider the testimony presented in the record in this proceeding, makes the following findings and conclusions:

1. The applications in this docket were filed pursuant to the regulations of the Commission and the Kansas statutes thus fulfilling the regulatory and statutory requirements.

2. The notice was proper in all respects and was published at least ten (10) days prior to the hearing as required by law.

3. The Commission, pursuant to K.S.A. 55-703, promulgated the Basic Proration Order for the Hugoton Gas Field. The Basic Proration Order seeks to permit gas production from a common source of supply in an equitable, non-wasteful manner consistent with market demand. The Basic Proration Order has been amended from time to time, as required to meet changes in the field conditions.

4. Amoco and Graham-Michaelis presented exhibits and testimony in support of the application. Richard Ruggiero, petroleum engineer, testified on behalf of Amoco. Lester Wilkonson, consulting petroleum engineer, presented exhibits and testified on behalf of Graham-Michaelis and a number of other small producers. No parties presented evidence in opposition to the applications.

5. Testimony presented by both witnesses indicated that the natural gas market is currently in a state of flux. Recent changes ordered by the Federal Energy Regulatory Commission (FERC) are now making it possible for the producers to take a more active role in the marketing of their gas. However, these FERC Orders, (436 and 451), are currently the subject of pending litigation at vaious levels of judicial review. For this reason, applicants argue that more time is needed for the market environment to stabilize. Another argument set forth by the applicants is that additional time will be required to make up the cancelled underage in addition to the sixty (60) months allowed. The record shows that many factors impact upon production capability including field presure, well presure, transportation ability and contracting ability. All of these factors will vary from producer to producer. This makes it virtually impossible to estimate with certainty how long it will take an individual producer to make up its underage. Amoco estimated that its underage could be made up in a little over sixty (60) months once the market changes are firmly in place. An additional argument set forth by Amoco is that the Commission itself will need some time to evaluate and recommend changes to market demand and underage procedures.

6. The evidence presented by the applicants established that the current moratorium should be extended. However, the evidence does not adequately demonstrate that either application should be granted in full. On that point, the sufficiency of the reasoning applied by the proponents becomes indefinite and inconclusive. In determining the proper amount of time to extend the moratorium, the Commission deems it appropriate to take the most conservative approach possible. This is consistent with the Commission's original moratorium Order of January 29, 1986. There, the Commission found that, "a five year extension . . . might serve to forestall production and exacerbate the correlative rights situation in the field." Therefore, the moratorium should be extended only for that amount of time which has been shown on the record to be absolutely necessary. On this point the record is instructive. Resolution of the FERC matters now pending in litigation could go on indefinitely. However, testimony presented by Amoco did venture that it may take two to three years to clear up those uncertainties. Adoption of the lower parameter of two years would be consistent with Mr. Wilkinson's testimony. There, he stated that the appeal of FERC Order 451 may take until 1990. As to FERC Order 436, it too is the subject of pending litigation. However, it is worth noting, as was pointed out at hearing, that FERC Order 500 was recently issued and is anticipated to resolve many of the points of contention with Order 436. An extension of approximately two years would also seem to be a reasonable amount of time to make up the cancelled underage in light of the estimates presented at hearing.

THE COMMISSION THEREFORE FINDS that the current moratorium deadline should be extended to December 31, 1989. The record indicates that this will allow an adequate time frame within which to reinstate and produce cancelled underage. The record also indicates that the FERC matters now pending in various stages of litigation may reasonably be expected to be resolved by that date.

IT IS THEREFORE BY THE COMMISSION ORDERED that paragraph (p) of the Basic Hugoton Order be amended to extend the current deadline for reinstating cancelled underages from September 30, 1987, to December 31, 1989. The amendments ordered herein, together with amendments ordered by the Commission in an Order granting the application of Mesa Operating Limited Partnership, Docket No. C-164, to be issued concurrently with this Order shall appear as follows:

> (p) Operators of wells and purchaser or others taking gas from any well, shall endeavor to limit their takes of gas to the quantities fixed in the schedule as the allowable production for such well, provided that if, during the period covered by any schedule, there should develop a substantial increase in the amount of the market demand for gas from said field, the Conservation Division may permit production to be increased ratably from all the wells in the field to meet such emergency increased demand and the facts respecting same shall be reported to the Commission at or before the next periodic market demand hearing for such action thereon as may be proper. If, at the end of any proration period, there is an overage or underage in production for any well during such period, the same shall be carried forward as a charge against or credit in favor of such well and subtracted

from or added to, as the case may be, the allowable for such well for the next proration period. Any well with an adjusted deliverability in excess of 300 MCF may accumulate overproduction equivalent to six times the amount of the current allowable assigned to it for the preceding January before being shut in by the operator or producer and shall not be permitted to produce any gas until such overproduction has been reduced by deductions from such overproduction made by current allowables to the extent that the well shall not be overproduced more than five times the current allowable assigned to it for the preceding January. When any well with an adjusted deliverability in excess of 300 MCF has accumulated underproduction in excess of six times the current allowable assigned to it for the preceding January, such excess shall thereupon be cancelled. Any well with an adjusted deliverability of less than 300 MCF may accumulate overproduction equivalent to nine time the amount of the current allowable assigned to it for the preceding January before being shut in by the operator or producer and shall not be permitted to produce any gas until such overproduction has been reduced by deductions from such overproduction made by current allowables to the extent that the well shall not be overproduced more than eight times the current allowable assigned to it for the preceding January. When any well with an adjusted deliverability of less than 300 MCF has accumulated underproduction in excess of nine times the current allowable assigned to it for the preceding January, such excess shall thereupon be cancelled. Any underage cancelled by the terms of this paragraph shall not be considered in determining the future production of any such well, unless, upon notice and hearing, the Commission shall otherwise determine. Provided, however, that in no event shall any underproduction of an unconnected well be cancelled.

For underage pior to January 1, 1975, an operator shall be allowed to request reinstatement of all or a portion of such underage any time up to December 31, 1983. The well shall not be required to be in an overproduced status to have underage reinstated. Any underage that is reinstated and not produced within the specified time limit shall be permanently cancelled.

For underage cancelled between January 1, 1975, and December 31, 1986, an operator shall be allowed to request reinstatement at any time prior to December 31, 1989. Any underage not reinstated or which has been reinstated and not produced according to these prescribed time limits, shall be cancelled permanently.

For underage cancelled after December 31, 1986, an operator shall have three (3) years from the date of cancellation to request reinstatement of such underage. Any cancelled underage not reinstated or which has been reinstated and not produced shall be cancelled permanently.

All applications for reinstatement shall state (1) that the well is physically capable of producing the reinstated underage in addition to the current allowable, (2) the length of time requested to make up the reinstated underage, which in no event shall be more than 60 months, and (3) the month, year, and volumes of underage cancelled.

Any operator with an order granting reinstatement of cancelled underage issued prior to February 16, 1983, may make application to the Commission for an extension of time in which to produce the reinstated underage. The additional time requested and the time period previously ordered shall not exceed 60 months. The application for an extension of time shall state that the well is physically capable of producing the remaining underage in addition to the current allowable, the amount of reinstated underage remaining to be produced, and the amount of additional time requested to produce the reinstated underage.

BY THE COMMISSION IT IS SO ORDERED.

Henley, Chmn.; Kowalewski, Com.; Wright, Com.
Dated: Sep. 16, 1987

/s/ Judith McConnell
Executive Director

Date Mailed:———

CERTIFICATE OF SERVICE

I hereby certify that on the —— day of September, 1987, I caused a true and correct copy of the foregoing Order to be served by placing the same in the United States Mail, postage prepaid, to the following parties:

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/s/ James E. Browne
Assistant General Counsel
Kansas Corporation Commission

———

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Keith R. Henley, Chairman
Rich Kowalewski
Margalee Wright

In the matter of the application of AMOCO PRODUCTION COMPANY for an order granting a three-year moratorium within which to request reinstatement of underage cancelled between January 1, 1975, through September 30, 1984, under Paragraph (p) of the Basic Proration Order for the Hugoton Gas Field, including any necessary amendments thereto, all of which related to wells operated by Amoco Production Company and other producers in the Hugoton Gas Field in Kearny, Finney, Grant, Haskell, Morton, Stevens, Seward, Stanton, Gray, and Hamilton Counties, Kansas.	)	DOCKET NO. C-164
In the matter of the application of HELMERICH & PAYNE, INC. for an order extending from September 30, 1987, until September 30, 1988, a deadline to file applications for reinstatement under Paragraph (p) of the Basic Proration Order for the Hugoton Gas Field as applies to applicant's wells.	)	DOCKET NO. 156,374-C (C-22,590)

In the matter of the application of GRAHAM-MICHAELIS CORPORATION for an order amending Paragraph (p) of the Basic Proration Order for the Hugoton Gas Field to extend the time to September 30, 1992, within which to apply for reinstatement of underage cancelled between January 1, 1975, and September 30, 1987, and such other amendments as may be appropriate to afford all producers a reasonable opportunity to avoid permanent cancellation of underage.	)	DOCKET NO. C-164
	)	CONSERVATION DIVISION

ORDER NUNC PRO TUNC

Now, the above-captioned matter comes on before the State Corporation Commission of the State of Kansas on its own motion for an Order Nunc Pro Tunc correcting the Order issued in the above-captioned docket on September 16, 1987.

The Commission, being fully advised in the premises and having examined its records and files, makes the following findings and conclusions:

1. The Commission's Order of September 16, 1987, amended Paragraph (p) of the Basic Proration Order for the Hugoton Gas Field. The approved amendments appeared in the revised Paragraph (p) as ordered by the Commission. The revised Paragraph (p) appears without four (4) paragraphs which were unintentionally omitted from the final Order.

2. The following language which was first included in Paragraph (p) in an Order issued by the Commission on February 18, 1986, was inadvertantly omitted from the Commission's Order of September 16, 1987. The Commission finds that it should be amended to reflect changes ordered by the Commission in its Order issued September 16, 1987, and included in the revised Paragraph (p) as follows:

> All operators who applied for reinstatement before September 30, 1987, and were granted an order reinstating underage originally cancelled after January 1, 1975, may apply for an extension of time to produce such underage, provided, however, that in no instance shall such extension be beyond December 31, 1994.

3. The following language was inadvertantly omitted from the revised Paragraph (p) which appeared in the Commission's Order of September 16, 1987. The language remains unaffected by the amendments ordered in the September 16, 1987 order, and should be included as follows:

> Upon the filing of an application and a showing of the existence of exceptional circumstances such as an act of God, the Commission may order that underage not be permanently cancelled.
>
> The staff is directed to annually publish the over/under status of all the wells in the Hugoton Field beginning with the status as of December 31, 1982. The initial report shall be published no later than May 1, 1983.
>
> The basic allowable (preceding January current allowable) for new wells or wells retested with the approval of the Conservation Division shall be computed by using the same field allowable factor as was used for other wells in the preceding January.

4. In all other respects the Commission's Order of September 16, 1987, issued in the above referenced docket should remain in full force and effect.

IT IS, THEREFORE, BY THE COMMISSION ORDERED: That the Commission's Order of September 16, 1987, issued in the above-captioned docket shall be corrected and amended as set forth in paragraphs 2 and 3 of this Order. The revised Paragraph (p) of the Basic Proration Order for the Hugoton Gas Field shall provide as follows:

> (p) Operators of wells and purchasers or others taking gas from any well, shall endeavor to limit their takes of gas to the quantities fixed in the schedule as the allowable production for such well, provided that if, during the period covered by any schedule, there should develop a substantial increase in the amount of the market demand for gas from said field, the Conservation Division may permit production to be increased ratably from all the wells in the field to meet such emergency increased demand and the facts respecting same shall be reported to the Commission at or before the next periodic market demand hearing for such action thereon as may be proper. If, at the end of any proration period, there is an overage or underage in production for any well during such period, the same shall be carried forward as a charge against or credit in favor of such well and subtracted from or added to, as the case may be, the allowable for such well for the next proration period. Any well with an adjusted deliverability in excess of 300 MCF may accumulate overproduction equivalent to six times the amount of the current allowable assigned to it for the preceding January before being shut in by the operator or producer and shall not be permitted to produce any gas until such overproduction has been reduced by deductions from such overproduction made by current allowables to the extent that the well shall

not be overproduced more than five times the current allowable assigned to it for the preceding January. When any well with an adjusted deliverability in excess of 300 MCF has accumulated underproduction in excess of six times the current allowable assigned to it for the preceding January, such excess shall thereupon be cancelled. Any well with an adjusted deliverability of less than 300 MCF may accumulate overproduction equivalent to nine times the amount of the current allowable assigned to it for the preceding January before being shut-in by the operator or producer and shall not be permitted to produce any gas until such overproduction has been reduced by deductions from such overproduction made by current allowables to the extent that the well shall not be overproduced more than eight times the current allowable assigned to it for the preceding January. When any well with an adjusted deliverability of less than 300 MCF has accumulated underproduction in excess of nine times the current allowable assigned to it for the preceding January, such excess shall thereupon be cancelled. Any underage cancelled by the terms of this paragraph shall not be considered in determining the future production of any such well, unless, upon notice and hearing, the Commission shall otherwise determine. Provided, however, that in no event shall any underproduction of an unconnected well be cancelled.

For underage prior to January 1, 1975, an operator shall be allowed to request reinstatement of all or a portion of such underage any time up to December 31, 1983. The well shall not be required to be in an overproduced status to have underage reinstated. Any underage that is reinstated and not produced within the specified time limit shall be permanently cancelled.

For underage cancelled between January 1, 1975, and December 31, 1986, an operator shall be allowed to request reinstatement at any time prior to December 31, 1989. Any underage not reinstated or which

has been reinstated and not produced according to these prescribed time limits, shall be cancelled permanently.

All operators who applied for reinstatement before September 30, 1987, and were granted an order reinstating underage originally cancelled after January 1, 1975, may apply for an extension of time to produce such underage, provided, however, that in no instance shall such extension be beyond December 31, 1994.

For underage cancelled after December 31, 1986, an operator shall have three (3) years from the date of cancellation to request reinstatement of such underage. Any cancelled underage not reinstated or which has been reinstated and not produced shall be cancelled permanently.

All applications for reinstatement shall state (1) that the well is physically capable of producing the reinstated underage in addition to the current allowable, (2) the length of time requested to make up the reinstated underage, which in no event shall be more than 60 months, and (3) the month, year, and volumes of underage cancelled.

Any operator with an order granting reinstatement of cancelled underage issued prior to February 16, 1983, may make application to the Commission for an extension of time in which to produce the reinstated underage. The additional time requested and the time period previously ordered shall not exceed 60 months. The application for an extension of time shall state that the well is physically capable of producing the remaining underage in addition to the current allowable, the amount of reinstated underage remaining to be produced, and the amount of additional time requested to produce the reinstated underage.

Upon the filing of an application and a showing of the existence of exceptional circumstances such as

an act of God, the Commission may order that underage not be permanently cancelled.

The staff is directed to annually publish the over/under status of all the wells in the Hugoton Field beginning with the status as of December 31, 1982. The initial report shall be published no later than May 1, 1983.

The basic allowable (preceding January current allowable) for new wells or wells retested with the approval of the Conservation Division shall be computed by using the same field allowable factor as was used for other wells in the preceding January.

IT IS FURTHER BY THE COMMISSION ORDERED: That in all other respects the Commission's Order of September 16, 1987, shall remain in full force and effect.

BY THE COMMISSION IT IS SO ORDERED.
Henley, Chm.; Kowalewski, Com.; Wright, Com.
Dated: October 15, 1987

I CERTIFY THE ORIGINAL
COPY IS ON FILE WITH

The State Corporation Commission
Date Mailed: October 19, 1987

/s/ Judith McConnell
EXECUTIVE DIRECTOR

/s/ Judith McConnell
Executive Director

CERTIFICATE OF SERVICE

I hereby certify that on the 19th day of October, 1987, I caused a true and correct copy of the foregoing Order Nunc Pro Tunc to be served by placing the same in the United States Mail, postage prepaid, to the following parties:

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/s/ James E. Browne
Assistant General Counsel
Kansas Corporation Commission

REPLY

BRIEF

FILED
OCT 31 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1856

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

NORTHWEST CENTRAL PIPELINE CORPORATION,
Appellant,

v.

STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, *ET AL.*,
Appellees.

ON APPEAL AFTER REMAND TO THE SUPREME COURT OF KANSAS

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October 31, 1988

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

No. 86-1856

NORTHWEST CENTRAL PIPELINE CORPORATION,
Appellant,

v.

STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, *ET AL.*,
Appellees.

REPLY BRIEF FOR THE APPELLANT

Appellant, Northwest Central Pipeline Corporation (Northwest Central), submits this brief in reply to the brief submitted by appellee, the State Corporation Commission of the State of Kansas (KCC) and the briefs of *amici curiae*, including the brief of the United States and the Federal Energy Regulatory Commission (FERC).[1]

I. THE KCC'S AMENDMENT TO PARAGRAPH (P) IS CLEARLY PREEMPTED BY THE NATURAL GAS ACT

Properly understood, this case is part of a decades-old struggle by the KCC to use its governmental power over natural gas production in Kansas to economically coerce Northwest Central and other interstate gas pipelines to take more rapidly their total contracted gas supplies from

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[1] The other briefs by *amici curiae* were submitted by (1) the Interstate Oil Compact Commission (IOCC), (2) five state and local governmental organizations (Council of State Gov'ts); and (3) six natural gas production-oriented state commissions and departments (Texas).

the Kansas Hugoton Field at the expense of contracted supplies from producing sources in other states. *Northern Natural*[2] was part of this same struggle. This case is *Northern Natural* in sheep's clothing.

A. The KCC's Rule Conflicts With Federally Approved Purchasing Practices

Northwest Central's gas markets, like the markets of other interstate pipelines, declined sharply beginning in the early 1980's. JS App. at 56a.[3] Northwest Central, therefore, has had to cut back on its purchases from all suppliers. Since Northwest Central, like other interstate pipelines, has gas purchase contracts in other states which require them to take or else pay for, whether taken or not, certain minimum volumes of gas, Northwest Central has exercised its contract right to reduce its purchases in certain fields, including the Kansas Hugoton Field, and take the minimum take-or-pay volumes under contracts in other states to the extent possible consistent with maintaining competitive rates.[4] By this purchasing practice, Northwest Central is able to minimize the costs for gas not taken, which its customers would otherwise have to bear.

After the submission of Northwest Central's initial brief on this appeal, the FERC in *Northwest Central Pipeline Corp.*, Opinion No. 312, 44 FERC (CCH) ¶ 61,222 (Aug. 4, 1988),[5] approved as prudent Northwest Central's purchasing practices in the Kansas Hugoton Field. In affirming the decision of its Administrative Law Judge, the Commission concluded that (44 FERC at 61,824-25):

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[2] *Northern Natural Gas Co. v. State Corp. Comm'n of Kan.*, 372 U.S. 84 (1963).

[3] References herein to "JS App." are to the Appendix filed with the Jurisdictional Statement. References to "J.A." are the Joint Appendix filed at the same time as Northwest Central's initial brief.

[4] *Northwest Central Pipeline Corp.* 33 FERC (CCH) ¶ 63,067, at 65,266, 65,278 (1985).

[5] Affirming the decision of the Administrative Law Judge, 33 FERC ¶ 63,067, at 65,266, 65,278.

> [P]reservation of low-cost reserves is obviously integral to a competitive purchasing strategy that considers multiple factors, and is not solely geared to using up lowest cost gas first, without thought to the future. Reserves not purchased would generally remain in the ground to be available for future purchases for the pipeline's customers.

These same purchasing practices are condemned by the KCC's brief in this case. KCC Br. at 11. It is clear, therefore, that there is a conflict between the Federal policy and the policy of the KCC. The policy of the KCC is to induce increased production from the Kansas Hugoton Field. The amendment to paragraph (p) is intended to achieve that state policy by making economically prohibitive a decision by a pipeline to spread its purchases from the Kansas Hugoton Field over a longer time than desired by the KCC. On the other hand, as shown by FERC's recent Opinion No. 312, Federal policy finds that it is prudent for the pipeline to purchase gas from the Hugoton Field at a more modest rate, preserving for future use the lower-cost Hugoton gas dedicated to interstate commerce, thereby minimizing the pipeline having to pay for gas which it cannot take under contracts in other producing areas.[6]

In its brief in No. 85-182 on the first appeal from the decision of the Kansas Supreme Court (*Kansas I*), reproduced in the Appendix hereto, the FERC admonished that the "state may not lawfully compel interstate pipelines, on pain of suffering a legal or economic penalty, to become unwilling partners with Kansas in requiring increased production of Kansas gas." (Appendix at 11). In an 180 degree reversal of its prior position, the FERC now claims that, "[t]he current KCC rule regarding underage cancellations is simply part of the matrix in which the pipeline's pur-

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[6] *Northwest Central Pipeline Corp.*; 33 FERC at 65,278; *see also Panhandle E. Pipe Line Co.*, Opinion No. 313, 44 FERC (CCH) ¶ 61,246 at 61,911-12 (Aug. 16, 1988).

chasing decisions must be made, just as virtually any other state regulation may affect the business decision of interstate companies. . . ." FERC Brief at 21. "To be sure, the KCC order may induce a pipeline to take more Hugoton gas. FERC, in reviewing the prudence of that decision, will be required to recognize the existence of the Kansas order as a factor affecting the pipeline's purchasing choice." FERC Brief at 22.[7]

The same argument could have been made, and in fact was made, in *Northern Natural* and *Transco* as applied to the Kansas and Mississippi Orders requiring pipelines to purchase gas ratably, if at all, from fields in those states. Obviously, if those Orders had been upheld, they would have been "part of the matrix in which pipeline purchasing decisions must be made" albeit at greater cost to the consumer. However, as pointed out by the Court in *Northern Natural* (372 U.S. at 92, 93), "this argument misses the point. Not the federal but the state regulation must be subordinated, when Congress has so plainly occupied the regulatory field."

The conflict is obvious from the following cross examination of the KCC's witness Mr. Cook who sponsored the amendment to paragraph (p) (J.A. at 54-55):[8]

> [96] BY MR. BROCK [Counsel for Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum, Inc.]:
>
> Q. On this matter of readjusting their takes from various sources of supply so that they could—within their market—so that they could take more from the Hugoton. If it was a choice between paying for gas not taken from other sources versus having underage cancelled here in the Hugoton, it could be a very expensive process for a purchaser to do that, is that not correct?
>
> A. Could be, yes.
>
> Q. For example, I believe, what, the Hugoton is having about 11, 12 billion cubic feet cancelled each month now?
>
> A. Yes.
>
> Q. And that would be extremely expensive for purchasers to take that much gas from other sources without—I mean [97] to pay for it without taking it, is that not correct?
>
> A. That's possible, yes.

[7] The FERC argues (at 22) that there is no conflict because the KCC's order will not dictate the outcome of any investigation of Northwest Central's purchasing patterns. This argument, however, misses the point. As shown above, there is a clear conflict between FERC's recently stated policy and the KCC's amendment. It is that conflict which necessitates a preemption finding.

[8] See J.A. at 148-149 showing the adverse impact that the Kansas rule would have on the cost of gas supply for Kansas-Nebraska Natural Gas Company, an interstate pipeline.

The conflict is further highlighted by Finding No. 12 of the Kansas District Court:

> "As a practical matter, the change in "P" will cause some permanent loss of underages (allowables) due to market conditions and will also cause a change in the 'mix' of natural gas which pipelines transport for sale many miles away." JS App. at 58a.

B. The Kansas Supreme Court's "Bright Line" Test Is Not Valid

When this case was before this Court on appeal from the *Kansas I* decision of the Kansas Supreme Court upholding the KCC's amendment to paragraph (p), the FERC took the position that the "case should be disposed of in light of this Court's decision in *Transco*." The FERC stated (at page 11):

> If the Court rejects our contentions in that case, it may so limit *Northern Natural* that the result reached by the courts below would clearly be cor-

> rect. Otherwise, this case should be remanded to the State Supreme Court for additional findings and analysis. As we have explained, the courts below incorrectly read *Northern Natural* as providing a "bright line" test depending simply on whether the state regulation directly addresses interstate purchasers.

After this Court's decision in *Transco*,[3] upholding the applicability of *Northern Natural* to the state of Mississippi regulations in that case, the Court remanded the *Kansas I* decision to the Kansas Supreme Court. The Kansas Supreme Court, however, did not remand the case to the KCC for further findings or for the taking of additional evidence. Instead, it simply issued its decision here on appeal (*Kansas II*), distinguishing *Transco* on the basis of the same incorrect "bright line" test as employed in the *Kansas I* decision (JS App. at 10a-11a):

> We have reexamined our decision in light of *Transco*, as suggested by the U.S. Supreme Court. From that reexamination, we conclude this case is distinguishable from *Transco*. There, the state regulation is addressed to gas purchasers. Here, the amendment to paragraph (p) of the basic proration order for the Kansas Hugoton Gas Field pertains to gas producers.

Although the Kansas Supreme Court in *Kansas II* made no additional findings as suggested by FERC and employs the same "bright line" test for distinguishing *Transco* as the *Kansas I* decision did for distinguishing *Northern Natural*, the FERC has now reversed its field. It now joins the KCC in urging that the *Kansas II* decision is correct. This flies in the teeth of the FERC's earlier brief emphasizing that (at 8-9):

> as this Court recognized in *Northern Natural*, the purposes underlying preemption in this area do

[3] *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Bd.*, 474 U.S. 409 (1986).

not in fact permit such a simple, "bright line" analysis. Instead, as the Court there explained (372 U.S. at 91-92 (footnote and citation omitted)):

> [t]he federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, * * * or for state regulations which would indirectly achieve the same result. * * * [S]tate orders [that] necessarily deal with matters which directly affect the ability of the Federal Power Commission [now the Federal Energy Regulatory Commission] to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act * * * invalidly invade the federal agency's exclusive domain.

We submit that FERC's earlier analysis is correct. This case should be reversed and remanded because the decision in *Kansas II*, like the decision in *Kansas I*, "incorrectly read[s] *Northern Natural* as providing a "bright line" test depending simply on whether the state regulation directly addresses interstate purchasers." (FERC Brief in *Kansas I*, at 11).

C. The KCC's Amendment Is Not Saved By Section 1(b) Of The Natural Gas Act

Much of the answering briefs are devoted to the same arguments made in *Northern Natural* and *Transco* that the KCC action in this case falls within the traditional regulatory power of producing states to regulate production, which is excluded from Natural Gas Act jurisdiction by Section 1(b), 15 U.S.C. § 717(b). E.g. KCC Br. at 4. They also argue that the KCC's order is "a legitimate conservation measure properly directed at producers." (*e.g.* KCC Br. at 23). But as explained in *Northern Natural*:

> the problem of this case is not as to the existence or even the scope of the State's power to conserve its natural resources; the problem is only whether the Constitution sanctions the particular *means* chosen by Kansas to exercise the conceded power if those *means* threaten effectuation of the federal regulatory scheme.

372 U.S. at 93 [10] (emphasis supplied).

Thus, the ultimate question is not whether the state's action was a legitimate measure, or whether Section 1(b) of the Natural Gas Act is applicable. Rather, the question is whether the state's action "amounts to a regulation in the field of gas transportation and sales for resale that Congress intended FERC to occupy." *Schneidewind v. ANR Pipeline Co.*, 108 S.Ct. 1145, 1153 (1988). *See also Arkansas La. Gas Co. v. Hall*, 453 U.S. 571, 584 (1981) ("[n]o appeal to equitable principles can justify this usurpation of federal authority").

The acknowledged purpose of the challenged Kansas order is to compel increased purchases of Kansas gas in the interstate market, with no regard for the effect this result would have on the national interest or the federal regulatory scheme. See JS App. at 37a, 39a-40a (Dissent at 46a-52a), 57a-58a, and 73a. As stated by the Kansas Supreme Court:

> "The order in the instant case gives us pause. It obviously is intended for purchasers, but is directed to producers. . . . The Commission does not dispute that its order will have an impact upon 'all facets of the market including interstate commerce.' " JS App. at 9a-10a.

The means chosen by the KCC presents the producers and their interstate pipeline purchasers with two consti-

[10] " 'The test . . . is whether the matter on which the State asserts the right to act is in any way regulated by the Federal Act.' " *Schneidewind v. ANR Pipeline Company*, 108 S.Ct. 1145, 1156 n. 13 (1988), *quoting Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947).

tutionally unacceptable alternatives. If the KCC succeeds in its purpose of forcing increased production and purchases of Kansas gas by interstate pipelines, the result would be a distortion of the national natural gas market and an inevitable conflict with federal regulation of the cost and purchasing patterns of the pipelines.

If the order fails to stimulate the volume of production deemed appropriate by the KCC, the coercive element of the order would come into play. The permanent cancellation of allowables would cause interstate pipelines to forever lose the right to take gas that heretofore has been available from producers whose gas has been dedicated to interstate commerce. JS App. at 58a.

Under either resulting scenario, the Kansas rule will thus infringe the authority of the FERC to regulate the cost structures of interstate pipelines. See *Northern Natural*, 372 U.S. at 92.

Moreover, the conservation purpose of the KCC's amendment is suspect. Neither the KCC nor the Kansas Supreme Court explained how the correlative rights of underproduced operators would be protected by an order cutting off their right to future compensating drainage. Northwest Central Br. at 30. Indeed, the KCC's amendment essentially puts back in place the rule of capture by allowing overproduced wells to produce not only their share of the gas, but also gas which properly belongs to other producers without being subjected to future compensatory drainage. J.A. at 57-59, 89-92. As the Chief Justice of the Kansas Supreme Court succinctly stated in his dissent, "the only viable testimony in the record shows clearly that waste will be caused, not prevented, by the orders, and that correlative rights will be violated not protected. . . ." JS App. at 49a.[11]

[11] The KCC (Br. at 14) asserts that its actions were legitimate as shown by the fact that uncompensated drainage may occur if its proposal is not adopted. "Unless the drainage from the shut-in wells is stopped, [the shut-in producer] may be unable to produce his entire

D. The KCC's Rule Conflicts With The Abandonment Provisions Of The Natural Gas Act

As to the conflict with the federal regulation on abandonments, the FERC now contends that even if the Kansas Rule results in uncompensated drainage, it would not conflict with the abandonment provisions of Section 7(b) of the Natural Gas Act, 15 U.S.C. §717f(b) (Br. at 23-26). This again is contradicted by the FERC brief in *Kansas I*, stating (at 10, n. 7):

> Indeed, if the state's order would result in drainage of gas dedicated to interstate commerce (J.S. 7 n. 2 18-19), this would raise serious questions affecting the Federal Energy Regulatory Commission's authority apart from any consideration of pipeline purchasing practices (Gov't Br. at 12, *Transco*). Gas that is dedicated to interstate commerce may not be diverted from that commerce without Commission "abandonment" authorization under Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b). See generally *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 542 (1979); *California v. Southland Royalty Co.*, 436 U.S. 519, 525-526 (1978); *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 156 (1960).

FERC's new position is also directly contrary to a decision of the Federal Power Commission (FPC), FERC's predecessor, finding that uncompensated drainage of gas from interstate wells was subject to NGA Section 7(b)

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accumulated underage by the end of the field's life." *Id.* The KCC, however, fails to recognize that the shut-in producers' correlative rights undoubtedly will be violated if its amendment to paragraph (p) is adopted because that producer will lose his right *permanently* to compensating drainage. *See* JS App. at 50a; J.A. at 91. That is a far clearer violation of correlative rights than the KCC's speculation that the field may be too depleted at some future time to allow compensating drainage. Indeed, the hollowness of the KCC's claim is shown by the fact that the producers that have been shut-in have opposed the KCC's amendment, thus indicating their belief that the KCC's amendment will lead to a correlative rights violation. *See* JS App. at 70a-71a.

requirements. *United Gas Pipeline Co. v. McCombs*, Opinion No. 740-B, 55 F.P.C. 202 (1976).[12] In that case, the FPC detailed an example in which wells dedicated to interstate commerce and nondedicated wells shared a common reservoir with "all of the current production, or a substantial part of the current production" from the nondedicated wells. 55 F.P.C. at 207. Under those circumstances, the FPC concluded that there would be "drainage, or net drainage, of the reserves underlying . . . the dedicated leasehold" and that "Section 7(b) abandonment authorization should be and is required. . . ." *Id.*

Moreover, the FERC's argument is erroneously premised on its belief that "Federal law simply does not extend to unproduced gas." *See* FERC Br. at 25. This Court's decision in *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, shows clearly that FERC misstates the scope of Federal law. There, the Court held that NGA Section 7(b) applied to a deeper reservoir of gas even though no deliveries from that reservoir had ever been made in interstate commerce. *Id.* at 542. The Section 7(b) requirement attached once the since-depleted shallower reservoir was certificated by FERC's predecessor, the FPC, even though the deeper reservoir was not discovered until almost twenty years after certification. *Id.*, at 540, 542. Thus, the Court clearly held that NGA Section 7(b) applied even to unproduced gas.[13]

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[12] FPC Opinion No. 740-B was affirmed in *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529 (1979).

[13] In *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392, 402 (1965), this Court held that "even though a sale of natural gas in interstate commerce occurs before production or gathering is ended, it is nonetheless subject to regulation." *See also Arkansas La. Gas Co. v. Amarex, Inc.*, Opinion No. 798, 58 F.P.C. 1617, 1628, 1635 (1977), *affirmed sub nom. Amarex, Inc. v. FERC*, 603 F.2d 127 (10th Cir. 1979), *cert denied*, 444 U.S. 1102 (1980) (The FPC maintains continuous federal control over dedicated reserves "whether or not they are producing natural gas at any particular intervening point in time" and whether the reserves are "proven or unproven") and 18 C.F.R. § 2.64 (FERC's regulations require approval under Section 7(b) of the aban-

Finally, the FERC (at 24) baldly asserts that no conflict exists because any producer would need to obtain authorization from FERC before abandoning these dedicated reserves elsewhere. As demonstrated in our opening brief (at 25-26), however, that abandonment proceeding would be a hollow exercise if the gas has already been permanently lost by drainage. It is analogous to "closing the barn door after the horse is gone."

The KCC (at 27) argues[14] that FERC has made no finding in this case as to abandonment, so this Court is without a factual basis to review the conflict with the abandonment provisions of the NGA. Whether FERC makes factual findings or not, the KCC's amendment to paragraph (p) conflicts with NGA Section 7(b) because the KCC's action can result in the permanent loss of dedicated interstate natural gas supplies even though FERC has exclusive jurisdiction over such abandonment. Northwest Central Br. at 12, 24-26.

Also, on this issue the KCC now claims (at 12-13) for the first time that the operators of the shut-in wells "will not be penalized by having their back underages cancelled." The KCC asserts that this results because the allowables for shut-in wells will automatically increase under the basic proration formula because of the pressure increase stemming from the wells shut-in. This argument must be rejected for a number of reasons.

First, it is not based on any findings of the KCC or the courts below. Instead, it is a *post hoc* rationalization

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donment of acreage that is being transferred even if it "is not productive at the time of transfer. . . .").

[14] The KCC (at 27) erroneously argues that this is the first time that this issue was raised. This issue is part of the overall preemption question. It was included in Northwest Central's May 21, 1987 Jurisdictional Statement. *See* JS at i. It was also raised by Northwest Central and the FERC in their respective briefs in No. 85-182 on appeal from *Kansas I*. Northwest Central Br. at 15; FERC Br. at 10, n. 7.

of counsel.[15] This Court has repeatedly admonished that it "cannot 'accept appellate counsel's *post hoc* rationalizations for agency action'; for an agency's order must be upheld, if at all, 'on the same basis articulated in the order by the agency itself.'" *FPC v. Texaco, Inc.*, 417 U.S. 380, 397 (1974), *quoting Burlington Truck Lines v. United States*, 371 U.S. 156, 168-69 (1962). Second, this *post hoc* argument is contrary to the record evidence which demonstrates that the KCC's amendment will, in fact, ultimately lead to a loss of reserves notwithstanding any purported future increase in allowables.[16]

Moreover, the KCC's new-found argument is not credible. If the permanent cancellation of underages will not threaten the permanent loss of dedicated reserves through drainage, then why was the amendment to ordering paragraph (p) enacted? How would ordering paragraph (p) serve as an inducement for pipelines to take gas more rapidly from the Hugoton Field, which was the purpose of the rule? The argument of the KCC is belied by the purpose of this rule to induce pipelines to take a greater share of their gas from the Hugoton Field.[17]

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[15] At page 14-15 of its brief, the KCC purports to show by a hypothetical example that, after not producing for nine periods, a producer could in the tenth period reinstate and produce all of its backlog. By periods, we assume the KCC is referring to market demand periods of six months. Thus, under its hypothetical, a well would be required to produce allowables assigned for a five-year period in only six months. This hypothetical was not presented in evidence and had it been present it would have been shown to be totally unrealistic. Moreover, it is contrary to the record. J.A. at 38, 57-58, 90-93.

[16] *See e.g.* J.A. at 38 (KCC Staff witness admitted that the producer would lose reserves by cancellation of underage); J.A. at 58, 65-68, 73 (Amoco testimony stating that it (as a shut-in producer) would lose some reserves notwithstanding any increase in allowables); J.A. at 91, 101-103 (witness for Cabot Petroleum Corp., *et al.* testified that the permanent cancellation will prevent future compensating drainage and that any gain in allowables will not prevent the permanent loss of reserves which would result from the KCC's action).

[17] The Kansas Supreme Court recognized that interstate pipelines like Northwest Central will be physically unable to take sufficient quantities

In any case, if the Court is unclear as to the conclusions to be drawn from the record evidence on the effect of the KCC's rule, the appropriate course would be to remand this case for further findings, as stated by the FERC in its *Kansas I* brief (at 11-13). *See FPC v. Transcontinental Gas Pipe Line Co.*, 423 U.S. 326, 331 (1976).

II. THE KCC'S AMENDMENT ALSO VIOLATES THE COMMERCE CLAUSE

In its initial brief, Northwest Central demonstrated (at 31-35) that the amendment to paragraph (p) also violates the Commerce Clause.[18] In response, the KCC (at 31) first asserts that its amendment does not discriminate against interstate commerce or favor in-state economic interests because "[t]he Commission's order protects the rights of all producers in the field regardless of the destination of a specific well's gas."

While on its face the KCC's order nominally applies to all producers, its impact clearly discriminates against interstate interests. The record shows that the underages which will be permanently cancelled will be those associated with interstate markets, not the intrastate markets. See JS App. at 55a-56a; J.A. at 57-59, 96. This permanent cancellation will prevent interstate producers and pipelines

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of gas to prevent cancellations of some underages with a resulting effect on dedicated reserves. The court noted that "[h]istory indicates market changes sufficient to make up underages have taken six to ten years." JS App. at 19a. Yet, the KCC's order mandates that a well must be in an overproduced status before any cancelled underage may be reinstated, and further exacerbates this problem by requiring any reinstated underage to be produced within five years. JS App. at 79a-80a.

[18] The Council of State Governments (at 22) asserts that *Champlin Refining Co. v. Corporation Comm'n of Okla.*, 286 U.S. 210, 235 (1932) stands "as a formidable barrier to appellant's Commerce Clause challenge to the KCC order. . . ." The simple response to this argument is that, as shown above, the instant case involves a regulation which is simple economic protectionism and which attempts to induce interstate natural gas pipelines to purchase more natural gas from Kansas Hugoton wells. Thus, *Champlin* is clearly distinguishable since it did not involve any such similar facts. *Cf. Northern Natural*, 372 U.S. at 94.

from obtaining "the corrective or compensatory drainage which was the hallmark of the prior [KCC] order for years" and will "cement for all time" the discrimination against out-of-state producers. JS App. at 50a. The KCC's order, thus, ensures that the intrastate producers will be able to produce their share of the gas in the field as well as gas which would normally be sold in the interstate markets without later being subjected to compensatory or corrective drainage. This is surely not even-handed regulation; it is economic protectionism. *See New Energy Co. of Ind. v. Limbach*, 108 S.Ct. 1803 (1988).

Moreover, the record plainly demonstrates that the purpose of the amendment was to coerce interstate natural gas pipelines to purchase more rapidly their contracted gas reserves from Kansas Hugoton, which would result in cutting back on purchases in other states. As shown previously, the Kansas Supreme Court found, "[t]he order . . . obviously is intended for purchasers, but is directed to producers." JS App. at 40a, 46a, 58a; J.A. at 36, 49, 50. In this way, the KCC has effectively "'project[ed] its legislation' into other States, and directly regulated commerce therein. . . ." *Brown-Forman Distillers v. New York State Liquor Auth.*, 476 U.S. 573, 584 (1986), *quoting Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 522 (1935). Nor is the KCC correct in its claim that its order does not constitute an impermissible burden on interstate commerce. As explained in Northwest Central's opening brief (at 34-35), the KCC's amendment cannot pass muster under the balancing test of *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970) because: (1) the burden on interstate commerce is substantial; (2) the order does not serve a legitimate local interest in preventing waste and protecting correlative rights; and (3) the KCC has alternate methods which would not burden interstate commerce.

The KCC's argument (at 33) that any impact on interstate commerce "is not unduly burdensome, but incidental" is at war with the previously quoted testimony of the KCC's staff witness who acknowledged that the amendment to paragraph (p) could lead to very substantial costs

to interstate purchasers in the form of increased take-or-pay costs arising under contracts in other states. J.A. at 54-55. Nor is this impact incidental because the record shows that such would be the direct result of the KCC's clear goal—to increase interstate pipeline purchases from Kansas-Hugoton at the expense of other states, as discussed above. This type of action was condemned by FERC as a violation of the Commerce Clause in its brief in the *Transco* case (No. 84-1076 at 12):

> Judged by its practical consequences, the order is plainly not a legitimate conservation measure, see *Northern Natural*, 372 U.S. at 93-94; instead, it reflects the very type of economic protectionism that has been uniformly outlawed as an impermissible burden on interstate commerce. See *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 580-582 (1981); *Maryland v. Louisiana*, 451 U.S. at 753-760; *City of Philadelphia v. New Jersey*, 437 U.S. 617 (1978). In short, the Board's order is a regulation of interstate commerce—one that stands on no better footing than the type of minimum price regulation this Court has already held invalid. *Cities Service Gas Co. v. State Corporation Comm'n*, 355 U.S. 391 (1958); *Northern Natural Gas Co. v. State Corp. Comm'n*, *supra*.

III. THE REMAINING ARGUMENTS RAISED IN SUPPORT OF THE KCC'S ACTIONS ARE WITHOUT MERIT

The KCC makes the shopworn argument (at 24), also made by the KCC in the *Northern Natural* case, that its new rule "is clearly the only viable conservation measure employable by the state."[19] This argument is not only incorrect, but it cannot justify the amendment to paragraph (p). As stated in *Northern Natural*, 372 U.S. at 94, "[o]f

[19] In *Northern Natural*, the KCC asserted that its regulation there involved was "essential for the conservation of natural gas." 372 U.S. at 93.

course, the Kansas method before us would fail, for the reasons given, even if it were Kansas' only means of achieving these ends."

As demonstrated in our initial brief (at 35), an alternative available to the state would have been to place greater limits on overproduced wells and/or establish production allowables in line with market demand. The record establishes that the KCC has established allowables substantially in excess of demands and that such action was a major cause of the underages which the KCC relies on to support its actions. JS App. at 26a, 45a. Additionally, the KCC could have left paragraph (p) in place unamended. In the past, substantial underages which were accumulated and cancelled were subsequently reinstated and produced once gas markets improved. JS App. at 19a; J.A. at 120-21. The KCC (at 6) asserts that the large underage problem was not caused by its establishment of allowables in excess of demand. Both the majority and the dissent in *Kansas I*, however, agreed that allowables were set "many times above the market demand." JS App. at 26a, 37a; *see also* JS App. at 45a. The District Court also stated that the underages have accumulated in part because interstate gas pipeline markets "have declined severely because of conservation, Federal intervention, competition with alternate fields and the recession." JS App. at 56a.[20]

In a tacit admission that the KCC's order conflicts with *Northern Natural* and *Transco*, Texas' brief (at 3, 7) urges this Court to use this case as a vehicle for reconsidering its decisions in those cases. But Texas has not met "the heavy burden of persuading the Court that changes in society or in the law dictate that the values served by *stare decisis* yield in favor of a greater objective." *Vasquez*

[20] The KCC attaches an exhibit to buttress its claim that it did not establish allowables in excess of demand. This exhibit, however, does not support that argument because it is on a total field basis so that the underproduced wells are balanced out by the overproduced wells. More importantly, this exhibit is misleading because it also fails to reflect the cancelled underages which would show allowables in excess of demand. J.A. at 76-78, 116-121.

v. Hillery, 474 U.S. 254, 265-66 (1986); *see also Arizona v. Rumsey*, 467 U.S. 203, 212 (1984) ("any departure from the doctrine of *stare decisis* demands special justification"). This is particularly true because the Court less than three years ago in *Transco* had the opportunity to revisit its 1963 decision in *Northern Natural* and chose not to overturn, modify or limit that decision in any way. Significantly, Texas has pointed to no changes since *Transco* which would warrant overturning either it or *Northern Natural*.

In support of its request, Texas' principal argument is that *Northern Natural* and *Transco* set standards that States cannot meet.[21] As demonstrated above, this argument is without merit because *Northern Natural* and *Transco* did not leave states powerless. Further, as previously explained, the Court in *Northern Natural*, 372 U.S. at 94, considered that possibility and held that the state's action nonetheless would be preempted "even if it were Kansas' only means of achieving these ends," as also noted above.[22]

Finally, Texas (at 17-18) and the Council of State Governments (at 21) assert that the KCC's amendment is consistent with the Congressional objectives in the Natural Gas Policy Act (NGPA) that natural gas wellhead prices are to be determined in accordance with free market principles. FERC (at 23) similarly argues that the KCC's amendment is consistent with FERC's policy of allowing the market for natural gas to develop in a competitive fashion.

These arguments are ironic, since Northwest Central's purchasing practices in the Hugoton Field are permitted under its contracts with the producers. It is the KCC which

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[21] See, however, *Northern Natural*, 372 U.S. at 94, n. 12.

[22] This is not, in any event, the case in which to overturn *Transco*. As discussed *infra*, virtually all of the gas at issue remains subject to continuing NGA jurisdiction, unlike the gas at issue in *Transco*. Thus, the concerns expressed in the dissent to *Transco* have no relevance here since the gas has not been deregulated by Congress. *See Transco*, 474 U.S. at 428.

seeks to interfere with the free market choice of Northwest Central as to its gas purchase mix; a mix which the FERC has concluded is prudent. *Northwest Central Pipeline Corp.*, 44 FERC at 61,824-25.[23]

Conclusion

For the foregoing reasons and those set forth in Northwest Central's initial brief, the Judgment of the Kansas Supreme Court should be reversed.

Respectfully submitted,

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October 31, 1988

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[23] Moreover, our opponents ignore the fact that the Hugoton gas here in question is old gas which was not deregulated under the NGPA. (Northwest Central Br. at 7-8).

APPENDIX

In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-182

NORTHWEST CENTRAL PIPELINE CORPORATION, ET AL.,
APPELLANTS

v.

CORPORATION COMMISSION OF KANSAS, ET AL.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

This brief is filed in response to the Court's order inviting the Solicitor General to express the views of the United States.

STATEMENT

1. Like other gas producing states, Kansas has laws "to prevent the inequitable or unfair taking of natural gas," Kan. Stat. Ann. § 55-703 (1983) (set forth as J.S. App. 99a-101a). One reason for these laws is that gas can migrate underground, from

underproduced areas of higher pressure to produced areas of lower pressure. Thus, it is theoretically possible to extract from a single well or group of wells all of the recoverable natural gas in the field, exhausting the unproductive or less productive wells (J.S. App. 5a-6a).

With a recent modification we shall describe, the Kansas Corporation Commission (Kansas Commission) has implemented state law since 1944 so that each gas well in the Hugoton Field [1] may "ultimately produce approximately the amount of gas underlying the lease upon which it is located." Basic Proration Order for the Hugoton Gas Field 12-13 (13 R. 37-38). Under these regulations, the Kansas Commission sets "allowables" for the Hugoton field—*i.e.*, gas production ceilings that assign to each producer the maximum amount of gas that may be produced from each well per month.

The rules are thus designed to spread market demand over all producing wells in proportion to their production capability. In practice, however, the wells cannot always meet their monthly allowables—a well may be "shut in" because of mechanical problems or the lack of a willing buyer of the gas, or it may voluntarily under- or overproduce. Consequently, the Kansas scheme uses production tolerances to account for under- or overproduction. If a well produces less than its allowable, it accrues an "underage," measured as the difference between its allowable and its actual production; in the same way, an overproducing well accrues "overages." Both underages and

[1] The Hugoton field extends across portions of Kansas, Oklahoma and Texas. About two thirds of the field is located in Kansas; that portion of the field contained more than 4,000 wells in 1983 (J.S. 3).

overages can be offset against future allowable levels. For example, a well can exceed its allowable by the amount of its underage if there is a purchaser for the extra gas and the well can physically produce it.

2. In February 1983, the Kansas Commission changed the underage rules to create "an incentive to operators to produce" (J.S. App. 62a).[2] The 1983 change provided, for the first time, that underages would be permanently cancelled if the producer did not reinstate [3] the underage by a certain time or, if reinstated, the underage was not produced within 3 years (J.S. App. 8a-9a). By its express terms, the rule change was "directed to and affects only those who drill for and produce gas from the Hugoton field. • • • [It] does not require pipeline[ ] purchasers to do anything or refrain from doing anything" (J.S. App. 75a).

[2] For most wells in the Hugoton field, underages had risen dramatically in recent years, reaching over 204 billion cubic feet of gas by 1982 (J. S. App. 62a), when the total natural gas production for all of Kansas in 1982 was a little over 430 billion cubic feet (American Gas Association, *Gas Facts: 1984 Data* 28, 29 (1985)). The Kansas Commission found that this high underage level stemmed from the fact that pipelines were not willing to purchase the gas up to the allowable levels. Because of relatively liberal production and sales contracting terms and the higher tolerances for underproduction in the Kansas Hugoton field, pipelines were using that field for "storage" and filling their gas needs elsewhere first (J.S. App. 22a).

[3] The state regulations provide that if a well accumulates underages equal to six times its monthly allowable, the underages are cancelled. Until the 1983 amendment, such "cancelled underages" could be reinstated at any time that the well was in an over-produced status and had a ready purchaser (J.S. 5).

3. Appellants, with other interstate pipelines, participated before the Kansas Commission in the rule-making preceding the rule change. They challenged the proposed rule change on the ground (inter alia) that it would unlawfully encroach upon the federal government's exclusive regulatory jurisdiction under the Natural Gas Act, 15 U.S.C. 717 *et seq.*[*] Appellants argued that cancelling underages would force them to purchase more Kansas gas at a time when they did not need the gas, and therefore that the state was in effect directing their purchasing practices, a matter exclusively the concern of the Federal Energy Regulatory Commission. See *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84 (1963).

After the Kansas Commission rejected these contentions, appellants sought judicial review of the new rule. The Kansas district court upheld the new rule (J.S. App. 41a-48a) on the theory that it involved the "production or gathering" of gas, and thus was a legitimate state act specifically excluded from the ambit of federal regulation by Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b).

---

[*] Most of the natural gas produced from the Kansas-Hugoton gas field is produced for and sold to interstate gas pipelines under certificates of public convenience and necessity issued by the Federal Power Commission (now the Federal Energy Regulatory Commission) under the Natural Gas Act (J.S. 3-4). This means that the gas is dedicated to interstate commerce and producers have a legal duty to sell their gas to the interstate market until relieved of that obligation by the Commission. Passage of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*, did not relieve producers from that obligation, because that Act specifically provides that gas flowing in interstate commerce before the NGPA was enacted generally remains under the Commission's Natural Gas Act authority (15 U.S.C. 3431(a)).

A divided Kansas Supreme Court affirmed (J.S. App. 4a-32a). While recognizing that the new rule had an "indirect effect to influence purchasers" and "even though purchasers are indirectly caught in the backwash," the majority upheld the rule against the challenge based on *Northern Natural* because the "rules on underages are a part of production regulation" over which the state has exclusive jurisdiction (J.S. App. 28a-29a). In dissent, Chief Judge Schroeder was of the view that the rule must fall, either on the ground that the Kansas Commission had exceeded its "statutory authority in fixing allowables far in excess of demand" (J.S. App. 33a), or alternatively, because the state regulation violated *Northern Natural*: while "directed at producers not purchasers, its real purpose is to create an impact on purchasers' business decisions concerning the makeup of their interstate gas mix" and therefore its effect is to impair the regulatory authority of the Commission under the Natural Gas Act (J.S. App. 34a-36a).

DISCUSSION

In *Northern Natural* this Court set aside state orders directing interstate gas pipelines to take gas ratably from Kansas wells under penalty of state law. In so ruling, the Court found that those orders "necessarily deal[t] with matters which directly affect the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sales of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act." 372 U.S. at 91-92. In that case, interstate pipelines had been directed, under the threat of state imposed criminal sanctions, to change their purchasing practices to balance the out-

put of the state's wells. In that situation, the Court concluded that "although collision between the state and federal regulation may not be an inevitable consequence, there lurks such imminent possibility of collision in orders purposely directed at interstate wholesale purchasers that the orders must be declared a nullity in order to assure the effectuation of the comprehensive federal regulation ordained by Congress." 372 U.S. at 92.

The question of the continuing validity of *Northern Natural* is currently before this Court in *Transcontinental Gas Pipe Line Corporation* v. *State Oil and Gas Board of Mississippi (Transco)*, No. 84-1076 (argued Oct. 8, 1985). We there argued that *Northern Natural* has continued validity in today's natural gas regulatory system. This case, unlike *Northern Natural* and *Transco*, involves a state order directed at the gas producers, rather than their purchasers. If we are correct in our contention in *Transco*, the question remains whether this difference in the state order serves to avoid the preemptive effect of the federal scheme.

1. The state courts believed that it did. In holding that *Northern Natural* has no application to the Kansas Commission's rule change, the state courts deemed the dispositive consideration to be that the rules here at issue, even though "obviously intended for purchasers," are in terms "directed to producers" and thus constitute a lawful exercise of legitimate state authority over the "production or gathering of natural gas" (J.S. App. 28a-29a). In reaching this conclusion, the state courts thus apparently view *Northern Natural* as having drawn a bright line between the federal and state regulatory interests based on whether the state action addresses purchasers or producers.

At first blush, this is an inviting approach. State control over the production of mineral resources is, as long recognized by the Court, an important aspect of state authority not to be overturned on preemption grounds absent the establishment of a legitimate federal purpose.[5] See, *eg.*, *Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210, 235 (1932) and cases there cited (upholding state proration orders applying only to the production and not to the sales or transportation of crude oil); see also *Thompson* v. *Consolidated Gas Utilities Corp.*, 300 U.S. 55, 69 (1937) (discussing the state's "undoubted power" to regulate gas production to prevent waste, and to create and protect correlative rights of owners of a common pool of gas against drainage). Indeed, in *Northern Natural* itself this Court recognized a "significant distinction" between "measures aimed directly at interstate purchasers and wholesale[r]s for resale [which are unlawful], and those aimed at producers and production" (372 U.S. at 94). The Natural Gas Act similarly recognizes this distinction in exempting from federal jurisdiction gas "production or gathering" (15 U.S.C. 717(b)).[6]

---

[5] We do not agree with appellants' suggestion (J.S. 13-14) that the rule change cannot reasonably be viewed as designed to affect the conduct of producers, because they need no incentive to produce and sell gas. It would not have been unreasonable for the State Commission to conclude that under the original system, producers might prefer to postpone sales in the hope they would obtain a higher price for their product in the future.

[6] Appellants incorrectly suggest (J.S. 15 n.3) that a state's "production or gathering" authority under Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b), covers only physical activities such as gas well drilling, spacing and the like. See *Northern Natural*, 372 U.S. at 90; see also *Shell Oil Co.*

2. But, as this Court recognized in *Northern Natural*, the purposes underlying preemption in this area do not in fact permit such a simple, "bright line" analysis. Instead, as the Court there explained (372 U.S. at 91-92 (footnote and citation omitted)):

---

v. *FERC*, 566 F.2d 536 (5th Cir. 1978), aff'd by an equally divided Court, 440 U.S. 192 (1979). The state rule here, which on its face is part of the state's general proration scheme ordering when and how gas can be produced (J.S. App. 51a), appears to fit squarely within the recognized area of regulation over the physical production of gas—*i.e.*, it determines how allowables may be exceeded at a given time to make up underages. Such state regulation through proration rules has long been viewed as regulating "production," not sales or transporation. *See Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210, 235 (1932) (state proration rules impose no impermissible burden on interstate commerce). *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965), upon which appellants rely, is not to the contrary. That case involved transactions the Court found to be "sale[s] of natural gas in interstate commerce" (381 U.S. at 402). It did not redefine the mutually exclusive spheres of state and federal jurisdiction demarked by the "production or gathering" exclusion of Section 1(b). Indeed, the Court's decision recognized that demarcation in noting that its decision "in no way interfer[ed] with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns" (381 U.S. at 403).

The passage of the Natural Gas Policy Act did not alter this basic demarcation. As the legislative history of the NGPA makes clear, its passage "does not contemplate that FERC will intrude into the traditional conservation functions performed by the states • • • who, in the exercise of their historical powers, will continue to regulate such matters as drilling locations, completion techniques, *production rates*, etc." (124 Cong. Rec. 38366 (1978) (remarks of Rep. Dingell, House Manager of the NGPA) (emphasis added)).

> [t]he federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, • • • or for state regulations which would indirectly achieve the same result. • • • [S]tate orders [that] necessarily deal with matters which directly affect the ability of the Federal Power Commission [now the Federal Energy Regulatory Commission] to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act • • • invalidly invade the federal agency's exclusive domain.

Appellants argue that the Kansas orders here are as inconsistent with federal regulation of interstate gas pipelines as the state scheme ruled invalid in *Northern Natural*, because the Kansas orders are designed to compel interstate pipelines to increase their takes of Kansas gas or lose forever their right to take such gas in the future (J.S. 7-8). Appellants contend that if they increase their Kansas takes, they must reduce their purchases from other producers, thereby incurring take-or-pay liability for the gas not taken and burdening their interstate customers with these added costs (J.S. 9, 16-18). On the other horn of the dilemma, they claim that if the gas is not taken now, their producers' underages could be permanently cancelled and gas originally destined for the interstate gas market customers could then effectively be diverted from appellants through drainage (J.S. 7 n.2). In sum, appellants' preemption claim rests on the assertion that interstate pipelines that exercise their contractual right to delay purchasing volumes of gas committed to them by their producers will lose the opportunity to buy that gas later (J.S. 16-18).

If appellants are correct, the state action cannot, we submit, stand under established preemption doctrine. As in *Northern Natural* the pipelines would effectively be required, under compulsion of state law, to change their purchasing practices to fit the parochial preferences of the state. This is the same conflict—or real possibility of conflict—between the state and federal schemes that required an otherwise valid state scheme to give way in *Northern Natural*, 372 U.S. at 94.[7] In such circumstances, it cannot be dispositive that the regulatory language used by the state is directed at gas production and producers. The inquiry instead must be whether the state action interferes with the federal scheme, no matter whether that interference is effectuated directly or indirectly.

Nor is it enough to save the state scheme merely to show that the challenged regulation serves a valid state interest. As this Court recognized in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 584 (1981) (citation omitted):

> [e]very pre-emption case involves a conflict between a claim of right under federal law and a claim of right under state law. A finding that

[7] Indeed, if the state's order would result in drainage of gas dedicated to interstate commerce (J.S. 7 n.2, 18-19), this would raise serious questions affecting the Federal Energy Regulatory Commission's authority apart from any consideration of pipeline purchasing practices (Gov't Br. at 12, *Transco*). Gas that is dedicated to interstate commerce may not be diverted from that commerce without Commission "abandonment" authorization under Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b). See generally *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 542 (1979); *California v. Southland Royalty Co.*, 436 U.S. 519, 523-526 (1978); *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 156 (1960).

> federal law provides a shield for the challenged conduct will almost always leave the state-law violation unredressed. • • • "[S]ince remedies form an ingredient of any integrated scheme of regulation • • • to allow the State to grant a remedy here which has been withheld [in the federal regulatory scheme] only accentuates the danger of conflict."
>
> The same principle applies here. • • • No appeal to equitable principles can justify [the] usurpation of federal authority.

3. This case should be disposed of in light of this Court's decision in *Transco*. If the Court rejects our contentions in that case, it may so limit *Northern Natural* that the result reached by the courts below would clearly be correct. Otherwise, this case should be remanded to the State Supreme Court for additional findings and analysis. As we have explained, the courts below incorrectly read *Northern Natural* as providing a "bright line" test depending simply on whether the state regulation directly addresses interstate purchasers. This Court's decision in *Transco* will undoubtedly shed further light on this issue, and it is appropriate for the state courts to grapple in the first instance with the application of the principles to be laid down in *Transco* to the somewhat different facts of this case.

Moreover, neither the Kansas Commission nor the Kansas courts made findings that could be highly pertinent to the correct resolution of this case. We submit that the state may not lawfully compel interstate pipelines, on pain of suffering a legal or economic penalty, to become unwilling partners with Kansas in requiring increased production of Kansas gas. The record would arguably support a finding that the state rule change had an impermissible coercive effect on the pipelines—in this case, that they should change

their purchasing practices or risk forfeiting the right to purchase gas in the future.[8] Since neither the Kansas Commission nor the Kansas courts made such a finding,[9] however, it would not be appropriate

[8] For example, while there was testimony before the Kansas Commission that the rule change would cause a loss of gas reserves (see, *e.g.*, 13 R. 544-547 (summarizing testimony)), but there was also contrary testimony (see 10 R. 179-180). The Kansas Commission's own expert testified on both sides of the question, declaring that cancelling underages would not mean losing reserves (9 R. 53) but might result in drainage (9 R. 86). There is no suggestion that the pipelines would forfeit gas that was already paid for; the controversy concerns only contractual rights to make future purchases.

[9] The only finding describing the effect of the rule change on the pipeline purchasers is that of the district court (J.S. App. 46a):

> [a]s a practical matter, the [rule] change * * * will cause some permanent loss of underages (allowables) due to market conditions and will also cause a change in the "mix" of natural gas which pipelines transport for sale many miles away.

The court leaves unanswered, however, the question whether the change in the pipelines' gas "mix" would result from pipelines being forced to purchase Kansas gas under the risk of losing contractual rights to take that gas at a future time. As the Kansas Supreme Court observed, the district court found "that the order would induce increased production" (J.S. App. 27a). Yet, there is no explanation of how or why this would happen.

Although appellants state (J.S. 7 n.2) that "it is clear that [loss of reserves] will occur with respect to a signficant number of wells in the Hugoton Field," their authority for this statement is simply a citation to those parts of the Kansas Supreme Court's opinion that summarize the appellants' contentions and their evidence; that court specifically declined to make any such finding, deferring instead to the Kansas Commission as the expert body. The dissent, also quoted by appellants, did not ground its conclusion regarding uncompensated drainage on any findings below. Compare J.S. App.

for this Court to atempt to make a finding concerning the effects of the rule change on the pipelines. It should instead, we submit, remand to the Kansas Supreme Court with directions that findings be made as to the effect of the rule.

This Court has made clear that "The exercise of federal supremacy is not lightly to be presumed." *New York Department of Social Services* v. *Dublino*, 413 U.S. 405, 413 (1973) (quoting *Schwartz* v. *Texas*, 344 U.S. 199, 202-203 (1952)); see also *Pacific Gas & Electric Co.* v. *State Energy Reserves Conservation & Development Comm'n*, 461 U.S. 190 (1983). This admonition has particular force in this case, in light of the statutory reservation to the States of authority over production and gathering.[10] We agree with the appellant that the States may not, under the guise of that authority, attempt to regulate the interstate market. But the mere existence of contracts committing gas to the interstate market does not deprive the States of the ability to modify, for proper allocation or conservation purposes, the legal rules governing production and gathering.

In sum, this Court should not, on this record, attempt to resolve the preemption issue in the context of complex state regulations dealing with gas conservation and production, "as thorny a problem as has

38a (dissent) with J.S. App. 6a (majority summary of effects of order change, noting principle of compensating drainage, leading to increase in allowables for underproducing wells, as tending "to keep the wells in balance in the long pull").

[10] In contrast, the state regulations at issue in *Northern Natural* and *Transco* are addressed directly to the actions of interstate pipelines, whose activities are comprehensively subject to federal regulation. While, for the reasons noted above, we do not believe this difference is in itself dispositive, it may well justify a somewhat more deferential approach to state regulatory attempts in the instant case.

challenged the ingenuity and wisdom of legislatures" (*Railroad Commission* v. *Rowan & Nichols Oil Co.*, 310 U.S. 573, 579 (1940)).[11]

CONCLUSION

For the foregoing reasons, the appeal should be held pending this Court's decision in *Transco*, No. 84-1076, and disposed of as appropriate in light of that decision.

Respectfully submitted.

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[11] Appellants' contention (J.S. 20-23) that the amended state rule is inconsistent with the Commerce Clause is based on the same contentions as to the effect of that change that underlie their preemption claim (page 9, *supra*), and would similarly be illuminated by further findings. If the rule change is invalid on preemption grounds, it is unnecessary to consider the Commerce Clause claim. Cf. *Middle South Energy* v. *Arkansas Public Service Comm'n*, 772 F.2d 404, 411 (8th Cir. 1985) (disposing of case on Commerce Clause grounds, rather than addressing preemption claims). But if the state action is acceptable regulation of production, an area reserved by the federal statute to the states, with only a permissible incidental effect on interstate commerce, the Commerce Clause challenge necessarily fails. See *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970); *Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210, 235 (1932).

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AMICUS CURIAE

BRIEF

MOTION FILED
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No. 86-1856

In The

Supreme Court of the United States

October Term, 1988

Northwest Central Pipeline Corporation,

Appellant,

vs.

State Corporation Commission of the State of Kansas, et al.,

Appellees.

On Appeal After Remand to the Supreme Court of Kansas

MOTION OF INTERSTATE OIL COMPACT COMMISSION FOR LEAVE TO FILE BRIEF AMICI CURIAE AND BRIEF OF INTERSTATE OIL COMPACT COMMISSION IN SUPPORT OF APPELLEES

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State Corporation Commission of the State of Kansas, et al.,

Appellees.

On Appeal After Remand to the Supreme Court of Kansas

MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE*

Pursuant to rules 36 and 42 of the Rules of the United States Supreme Court (the Court), the Interstate Oil

*Consent has been given by Panhandle Eastern Pipeline Company, Southwest Kansas Royalty Owners Association, Mesa Operating Limited Partnership, Colorado Interstate Gas Company, The Kansas Corporation Commission, Amoco Production Company, Cabot Petroleum Corp., Northern Pump Co., Kansas Petroleum Inc. and Graham-Michaelis Corp.

Compact Commission (IOCC) respectfully moves the Court for leave to file the brief amici curiae annexed hereto.

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QUESTION PRESENTED

1. Whether the authority of the Kansas Corporation Commission, and similar conservation agencies in other states, to prevent waste and protect the correlative rights of the mineral interest owners of natural gas produced within their states and sold in interstate commerce has been preempted by the Natural Gas Act, 15 U.S.C. §717 *et seq.*, and the Natural Gas Policy Act of 1978, 15 U.S.C. §3301 *et seq.*

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No. 86-1856

In The

Supreme Court of the United States

October Term, 1988

Northwest Central Pipeline Corporation,

Appellant,

vs.

State Corporation Commission of the State of Kansas, et al.,

Appellees.

On Appeal After Remand to the Supreme Court of Kansas

AMICI BRIEF OF INTERSTATE OIL COMPACT COMMISSION

INTEREST OF THE AMICI CURIAE

The Interstate Compact to Conserve Oil and Gas is an agreement among oil and gas producing states, initially ratified by six states in 1935. It was approved by the Congress in that year and has continued to be in force since August 27, 1935. The agreement declares in one section that:

> The purpose of this Compact is to conserve oil and gas by the prevention of physical waste thereof, from any cause. (Article II).

Twenty-nine states are now members.

The Interstate Oil Compact Commission (IOCC), whose members are the Governors of the signatory states, is the administrative agency that carries out the purpose and functions of the Compact by developing and disseminating information relating to effective conservation programs. Each state has a direct, economic, social and vital interest in the exploration, development and conservation of its natural resources. Each state also has the responsibility under constitutional provisions to protect the correlative rights and interests of the many owners of the oil and gas resources in the state, subject to reasonable regulation to prevent waste. Although uniformity of conservation regulations among the member states does not, and should not, exist because of the variations in geology, producing conditions, marketing, economics, and other factors that exist with regard to properties, wells, and pools, all statutes and regulations require the prevention of waste and the protection of correlative rights.

Historically, the responsibility for oil and gas conservation has been vested in and exercised by the states. The desirability of state regulation has been recognized by the Congress, the Supreme Court of the United States, and numerous agencies and departments of the federal government. In the House of Representatives subcommittee hearings on the Natural Gas Act in 1936 Mr. Dozier A. DeVane, the Solicitor General of the Federal Power Commission (FPC) responded to a question from Congressman Cole of Maryland concerning the prevention of waste and promotion of conservation of natural gas with the following:

> The general opinion is that it can best be handled by state compacts. *Natural Gas Act. Hearing on H. R. 11662. Subcommittee of the Committee on Interstate and Foreign Commerce, House of Rep., 74th Cong., 2nd Sess. (1936) at 34-36.*

The question of whether a state has the authority to conserve its natural resources challenges the very foundation of the IOCC. Amici fears that invalidation of the Kansas Corporation Commission's (KCC) order amending Paragraph (p) of the Hugoton Basic Field rules would deprive the states of a time tested conservation tool, i.e. the regulation of production of natural gas from a common source of supply. Because this Court's decision could have a direct effect on the purpose of the Compact, the prevention of waste and protection of correlative rights, the IOCC at its mid-year meeting unanimously adopted a resolution directing the General Counsel to file a brief in this case.[1] The IOCC submits this brief to assist the Court in its resolution of this case.

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[1] RESOLUTION CONCERNING THE PRESERVATION OF THE STATES' AUTHORITY TO PREVENT WASTE AND PROTECT CORRELATIVE RIGHTS

WHEREAS, the Interstate Oil Compact Commission (IOCC) is an organization composed of 29 oil and gas producing states formed for the principal purpose of conservation of oil and gas and promotion within the respective states of responsible oil and gas production activities through adherence to the goals of the prevention of waste and the protection of correlative rights; and

WHEREAS, the United States Supreme Court, on May 23, 1988, noted probable jurisdiction in the case of *Northwest Central Pipeline Corporation v. Corporation Commission of Kansas*, 240

(Continued on following page)

STATEMENT OF THE CASE

At issue in this case is the constitutionality of an order entered by the Kansas Corporation Commission (KCC) designed to prevent waste and protect correlative rights of the mineral interest owners of natural gas produced in the Hugoton Field. Amici believes that in order to fully understand the import of this case, a brief history of the promulgation of conservation statutes would be helpful.

(Continued from previous page)

Kan. 638, 732 P.2d 775 (1987) involving the validity of an order issued by the Kansas Corporation Commission, the state agency responsible for oil and gas conservation in the State of Kansas; and

WHEREAS, the decision of the Supreme Court in the *Northwest Central Pipeline* case will involve application of the legal principle of federal preemption of state authority to prevent waste and protect correlative rights; and

WHEREAS, the compacting states, whether or not their respective conservation laws authorize market demand proration, are concerned over the potential for a decision in the *Northwest Central Pipeline* case which would restrict state regulatory authority over gas conservation in favor of federal authority; and

NOW, THEREFORE, BE IT RESOLVED by the IOCC that its General Counsel is directed to prepare and take such steps as are procedurally necessary to file on behalf of the IOCC a brief *amicus curiae* in the *Northwest Central Pipeline* case in support for the general policy of retention of state oil and gas conservation agency authority over the prevention of waste and the protection of correlative rights as against any claimed federal preemption and enunciating the IOCC's concern that the Supreme Court not impinge upon such state agency authority in the *Northwest Central Pipeline* decision.

In the infancy of the oil and gas industry conservation statutes were non-existent. In fact, the concept of preserving a precious natural resource from squander and waste was just beginning to form in the national conscience. Oil and gas reservoirs, like the East Texas Oil Field, were being rapidly depleted. Reservoirs were produced to their absolute maximums, with sound conservation measures being neglected. In what can only be described as a national catastrophy, reservoir energy was being uselessly wasted, with millions of barrels of oil consequently being left in the ground, lost forever. Even more incredible, in cases where natural gas was found in conjunction with oil (associated gas), the natural gas was flared, literally burned away in order to allow oil production to continue. In the early 1930's the prognostication was clear, the industry was producing itself out of business and the energy resources of the nation were being squandered.

The driving force behind this mad rush towards overproduction was the rule of capture. It is an elementary maxim of property law that a landowner has the right to produce the oil and gas under the landowners' property. The rule of capture allows the landowner to claim all of the minerals produced from wells on his land. However, oil and gas in a common reservoir respects no property lines. In a situation where there are multiple landowners and minerals owners in a common source of supply, a landowner who produces gas can easily drain the gas from an adjoining landowner. The only remedy for the adjoining landowner, under the rule of capture, is to drill wells and produce the minerals as fast or faster

than his neighbor. This incentive creates a rush for production which if left unchecked destroys correlative rights and wastes reservoir energy, resulting in gas which would have been recoverable being left in the ground.

Prior to the passage of the Natural Gas Act of 1938 and in a clear reaction to the wasteful abuses resulting from the rule of capture the producing states began adopting regulations governing the exploration and production of oil and gas. These states,[2] acting under their respective statutes, sought to end the wasteful excesses which resulted from the rule of capture. It is these statutes which are the foundation of the conservation laws that are in effect today. The state agencies, acting pursuant to the conservation statutes, regulate the amount of production in a field along sound conservation principles designed to allow efficient and prudent development of oil and gas from a common source of supply. Thus, the rule of capture and its consequences are effectively repealed by the passage of these conservation statutes. As one IOCC study stated:

> (a) failure to protect or adjust the correlative rights of common owners of a common source of supply of oil and gas may be one of the greatest factors contributing to the physical waste of oil and gas . . . Where, by statute or regulatory order, correlative rights are protected, so that each owner in an orderly manner is assured of the opportunity of recovering or receiving his fair share of the oil and gas from the common pool, the race is over and all have a common interest in the most efficient and economic recovery of the

[2] The 29 member states of the IOCC and six associate member states have enacted oil and gas conservation states.

> maximum volume of oil and gas from a common pool, which is true conservation.[3]

The natural gas industry has a system of dual regulatory authority. Pursuant to the Natural Gas Act of 1938, 15 U.S.C. §717, et seq., (NGA or the Act) and the Natural Gas Policy Act of 1978, 15 U.S.C. §3301, et seq. (NGPA) The Federal Energy Regulatory Commission (FERC) has jurisdiction over large segments of the natural gas industry. Activities pertaining to the sale and transportation of natural gas in interstate commerce are regulated by FERC. However, it is equally clear that the production and gathering of natural gas is reserved to the jurisdiction of the states. 15 U.S.C. § 717(b). The significance of the express reservation of the state's power to regulate production and gathering is noted in the legislative history of the Natural Gas Act. In briefs of various proponents, testimony in the hearings, and excerpts of the Congressional Record the intent is unambiguous, the Natural Gas Act was not intended to disturb the state's control over the prevention of waste and protection of correlative rights.

Kansas, like the other producing states, has enacted statutes and regulations charging the KCC with the duty to regulate the exploration and production of natural gas. The Kansas statutes require the prevention of waste and protection of the correlative rights of mineral owners. K.S.A. 1987 Supp. 55-703 states that a person having the right to produce gas from a common source of supply,

[3] A Study of Conservation of Oil and Gas in the United States, 1964 at 187.

> may produce only that portion of all the natural gas that may be currently produced without waste and to satisfy the market demands, will permit each developed lease to ultimately produce approximately the amount of gas underlying the developed lease and currently produce proportionately with other developed leases in the common source of supply . . .

The problems of preventing waste and protecting correlative rights exists in all oil and gas producing states. The simple fact is natural gas within a common source of supply tends to migrate from underproduced areas to produced areas. The technical explanation is that natural gas flows from areas of high pressure to areas of low pressure. (J.S.App. at 17a-18a). The basic proration order for the Hugoton Gas Field is designed to insure that each developed lease produces its fair share of the underlying natural gas in spite of this drainage phenomenon. To fulfill their statutory obligations to prevent waste and protect correlative rights, state agencies have adopted well spacing regulations, both as to well density and location of wells on the drilling unit. The assigning of production quotas (allowables) to wells within a common source of supply is frequently used in accomplishing their obligation to prevent waste and protect correlative rights. In order to fairly distribute the allowables to each well in a field, the KCC utilizes a formula to determine allowables. Although the particular formula adopted will vary depending upon the physical characteristics of the reservoir most formulas take into consideration the market demand for gas from the field, the deliverability of the well and the acreage attributed to each well.

In the Kansas Hugoton Field, the market demand, i.e., the total amount of gas to be produced during a

proration period, is determined by the Commission through the hearing process. Twice each year the Commission requests all purchasers or transporters, including Appellant, to submit their nominations to the Commission. After a public hearing and considering the nominations and other relevant factors the Commission determines the estimated market demand for Hugoton gas for the specific six month period.[4]

The principal factor in determining a wells' deliverability is the pressure of the well as compared to other wells in the field. Wells with higher pressures generally receive higher allowable assignments as opposed to lower pressure wells. Also, wells that are underproduced (or shut-in) as a rule have a higher pressure than wells that are currently producing their allowables. Once the market demand is determined, the allowable formula spreads that volume of gas among the wells in the field. Through the assignment of allowables on a well by well basis, the Commission fulfills its duty in allowing each landowner the opportunity to extract the gas underlying his land.

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[4] K.S.A. 55-703 states in part that, "The Commission in determining the market demand for gas from a common source of supply shall consider the reasonable current requirements for current consumption and use within and without the state, and such other factors, conditions, or circumstances that would aid in establishing the market demand". Although Appellant complains of the "excess allowables" assigned to wells connected to its pipeline it did not appeal the Commission's orders determining the market demand or setting those allowables.

It is an elemental fact that gas wells produce only when its purchaser is taking the gas. Unlike oil, gas cannot be stored in any conventional sense of the word. When a purchaser is not taking the gas, the wells are shut-in. The Hugoton Field is one of the world's largest gas fields with hundreds of producers, thousands of wells and at least seven interstate and one intrastate purchasers. The result of this conglomeration of interests is that a number of wells are often shut-in at varying times. An existence of different levels of takes and the problems caused by shut-in wells has been long recognized by Kansas and other oil and gas producing states. From a conservation perspective the chief problem with shut-in wells is the problem of uncompensated drainage of gas that occurs due to the pressure differentials between producing and non-producing wells.

Prior to 1983, Paragraph (p) of the Basic Hugoton Field Proration Order provided that underproduced allowables would be cancelled, however, these cancellations could be reinstated and held onto indefinitely. Because of this, many purchasers of natural gas were simply using the Hugoton Field for a storage facility, in essence banking these reinstated underages.

The Order of February 16, 1983 amending Paragraph (p) of the Basic Proration Order was based upon two days of hearing and findings of fact issued by the Commission. Although the Hugoton Field has experienced various degrees of cyclic underproduction in the past, the situation in the early 1980's was severe. The testimony showed that the field was being used as a storage facility by many of the interstate purchasers. (J.A. at 47, 129-133). The experts testify that the lack of uniform production was

allowing the field to become badly out of balance, with correlative rights being violated on a continuing basis. (J.A. at 32-33, 35, 42-44, 122-123). Furthermore, it was evident that the indefinite accumulation of underages was a chief cause of the field becoming out of balance. Some experts at the hearings believed that the problem of an imbalanced field could be best addressed by lowering the allowable assignments through its market demand proceedings. The Commission rejected this evidence. The Commission found that correlative rights were not being violated due to the method of assigning allowables, but instead from the failure of the producers and the pipelines to take gas from the field. The Commission clearly concluded that the best way to correct the ongoing violation of correlative rights was to implement a policy designed to remove the incentive which allowed producers indefinite accumulation of underages in the Hugoton Field.

A history of Paragraph (p) demonstrates the need for the KCC to change the tolerance provisions of the Basic Proration Order as the field is depleted. Due to the conditions in the Hugoton Field in 1964 a moratorium on the cancellation of underages was ordered by the Commission, and stayed in effect until 1967. At that time the order was amended to include cancellation of underages in excess of 20 times the January basic allowable. This requirement was reduced to 18 times, then 15 times the basic allowable in 1968 and 1975, respectively. In October of 1975 the KCC terminated these conditions and returned to the 6 times the underproduced status as the requirement. Furthermore, in 1975 the order added specific provisions for reinstatement of cancelled underages

to wells which had become overproduced. Appellant has failed to challenge these modifications of Paragraph (p) in the past, even though each of these changes must have had some impact on the interstate commerce. Indeed, it is impossible to conceive of a conservation order which did not, in some manner, effect interstate commerce. However, the current modifications to Paragraph (p), like the past modification, only displays a minimal, unintended impact in contrast to the conservation purposes which are at the heart of the order. The amendment simply allows a producer three years in which to reinstate cancelled underages, and then five years from the date of the reinstatement to produce the underages, or the underages become permanently cancelled.

The purpose of the Commission's Order is to establish a policy which encourages the timely production of allowables. One final point needs to be made, the cancellation of accumulated allowables has absolutely no impact on the underlying reserves in the Hugoton Field. The cancellation of allowables merely removes the incentive to allow wells to be shut-in on a long term basis. When an allowable is canceled, the natural gas still stays in the ground, subject to the same contractual arrangements between the purchaser and the producer.

ARGUMENT

I. THE APPELLANT'S POSITION WOULD INVALIDATE STATE CONSERVATION STATUTES, AND WOULD FORCE A RETURN TO THE RULE OF CAPTURE

The tools used by state conservation agencies to fulfill their legislative and constitutional obligations to prevent waste and protect correlative rights of the mineral interest owners in a common supply of natural gas are spacing, both well density and the location of the well on the drilling unit, and the regulation of production. To protect the environment states also prescribe surface casing requirements, cement quality controls and produced brine and drilling mud disposal regulations. All of these regulations have an indirect effect upon the cost of gas to the ultimate consumer. An extension of the principals enunciated by the Court's majority opinion in *Northern Natural Gas Company v. State Corporation Commission*, 372 U.S. 84 (1963) could invalidate state gas conservation regulations. If state orders directed to producers, not pipeline purchasers, regulating rates of production of natural gas from common sources of supply are invalid, then the states have no other method of protecting correlative rights and preventing waste. It is undisputed that the FERC has no such authority under the NGA. Without regulatory protection of their property rights the rule of capture is once again the only vehicle by which mineral interest owners can protect their interest. The race to produce, with the inevitable waste of the resource will once again prevail. This is a result which this Court must not allow to happen.

The fixing of production quotas to prevent waste and protect correlative rights is meaningless without some method of enforcing the allowable orders. Since the *Northern* decision, states have been unable to require ratable taking by interstate pipelines.[5] If this order before the Court, directed only to producers, is invalidated, the only other possible tool left to the states would be to limit the production from the field to the purchaser which needs the least amount of gas. Those purchasers demanding more gas to meet their interstate requirements would be forced to purchase gas elsewhere or fail to meet their interstate requirements. Clearly, this would be a restraint on interstate commerce.

II. THE KCC ORDER AMENDING PARAGRAPH (P) IS NOT PREEMPTED BY THE NGA

The legislative history of the Natural Gas Act of 1938 makes it abundantly clear that the NGA was not intended to disturb the state in their exercise of jurisdiction over the prevention of waste and the protection of correlative rights. Behind the specific language of Section I(b), 15 U.S.C. 717(b) – that the Act shall not apply "to the production or gathering of natural gas" – lies a wealth of declarations, both by congressmen and by hearing witnesses, in committee reports, hearing testimony and floor debate, that the Act did not purport to disturb state

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[5] This is true even though ratable taking of gas does not require the purchaser to purchase and take the full allowable, it only requires the purchaser to take the same percent of the allowable assigned to each well in the field to which it is connected.

regulation of matters involving production and conservation of oil or gas.

Particularly noteworthy is the hearing testimony of Dozier A. DeVane, then Solicitor General of the Federal Power Commission (FPC), who played a major role in drafting much of the legislative language that was eventually enacted as the NGA. At a hearing in April 1936 of a subcommittee of the House Committee on Interstate and Foreign Commerce, DeVane was asked by Congressman Cole of Maryland why the bill addressed itself only to interstate price regulation and attempted to do nothing to promote conservation . . . " to prevent the outrageous waste of natural gas which is going on every day, and is going on this very minute." *Natural Gas Act. Hearing on H.R. 11662 before a Subcommittee of the Committee on Interstate and Foreign Commerce, House of Representatives, 74th Cong. 2d Sess. (1936) at 34*. DeVane replied that there was "some question as to the constitutionality of any act of the federal government that may attempt to regulate waste." *Id*. at 35.

DeVane's position was shared by Congressman Lea of California, Chairman of the Subcommittee, who amplified:

> The theory is that it has been a matter for state jurisdiction. The government does not have charge of mining or manufacturing raw products and is without sufficient power to assume control over waste. *Id*. at 36.

Mr. DeVane then added:

> The general opinion is that it can best be handled by state compacts. Now, whether that is practical or not

> I am unable to say, but there is no question but what it can be handled that way; no question but what compacts are legal. *Id.* at 36.

Later, Subcommittee Chairman Lea declared:

> The primary purpose of the pending bill is to provide federal regulation, in those cases where the state commissions lack of authority, under the interstate commerce law. This bill takes nothing from the state commissions; they retain all the state power they have at the present time . . . The bill does not apply to the production and gathering of gas. 81 Cong. Rec. 6721 (1937).

During the hearings on the bill in the senate, Senator Austin asked:

> *Mr. Austin*: Mr. President, may I ask the Senator from Montana [Mr. Wheeler] a question concerning this bill? Does the bill undertake to regulate the production of natural gas, or does it undertake to regulate the producers of natural gas?
>
> *Mr. Wheeler*: It does not attempt to regulate the producers of natural gas or the distributors of natural gas; only those who sell in wholesale in interstate commerce. 81 Cong. Rec. 9312 (1937).

From the legislative history of the Act, as well as from the language of the Act itself, it is unmistakeably clear that the Act was designed to fill a regulatory gap and give the FPC jurisdiction over interstate transportation and certain interstate sales of natural gas. It was not intended to limit in any respect the traditional powers of the states over the prevention of waste or the protection of correlative rights. Furthermore, concerning the question of whether the NGPA altered the NGA's express

exemption concerning production and gathering of natural gas, House Energy Committee Chairman John Dingell stated:

> The legislation [NGPA] does not contemplate that FERC will intrude into the traditional conservation functions performed by the states. This is a matter reserved to the state agencies who, in the exercise of their historical powers, will continue to regulate such matters as drillings, locations, completion techniques, production rates, etc. Of course, the Secretary of Energy is authorized under Section 505 to intervene as a matter of right in state proration proceedings. This intervention authority, however, does not grant the Secretary any substantive powers or displace any state authority.

124 Cong. Rec. 38,366 (1978)(statement of Rep. John Dingell).

Appellant totally misstates the questions presented by the Kansas Corporation Commission's order. Obviously, this is done to try to convince the Court that this is another *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, 474 U.S. 409 (1986) or *Northern* case. In contrast to *Northern* and *Transco*, the Commission's order does not require interstate pipelines to purchase more natural gas from Kansas and less from other states. The order requires pipelines to do nothing. Neither does the order divert gas dedicated to interstate markets to Kansas markets, as Appellant contends. The above propositions are illogical and contradictory. If the order forced interstate pipelines to run more Kansas gas to interstate markets, how could it divert gas to Kansas markets.

The Kansas order, as found by the Kansas Supreme Court, is a conservation order applicable only to producers and mineral interest owners in the Hugoton Field. Its purpose is to prevent waste and to protect the correlative rights of the mineral interest owners. Pipeline purchasers have no ownership in the gas, only the right to purchase the gas when produced. Appellant urges this Court to radically alter mineral law by elevating the purchaser's contractual right to purchase gas from a common source of supply above all other rights in that common source of supply.

III. THE KCC ADHERED TO THIS COURT'S ANALYSIS IN *NORTHERN* AND *TRANSCO*

Although Appellant seeks to present this case as a duplicate of *Northern*, it is specifically because of this Court's holding in *Northern* that the KCC order is lawful. In *Northern*, the KCC ordered interstate pipelines to take ratably from all wells in the Hugoton Field. The state orders were directed at gas purchasers and enforced by criminal sanctions. This Court made short work of the KCC's argument that even though the order was directed at purchasers the purpose of the order was to protect correlative rights and stop waste. The KCC relied upon the §1(b) language removing production and gathering of natural gas from FERC jurisdiction. After noting that production and gathering are terms narrowly confined to the physical acts of drawing gas from the earth and preparing it for the first stages of distribution, this Court stated: "Appellant is not a producer but a purchaser of natural gas from producers . . . " 372 U.S. at 90. Indeed, in drawing the distinction between *Champlin Refining Co. v. Corporation Commission*, 286 U.S. 210 (1931) and the facts in *Northern*, the Court opined:

> Thus our cases have consistently recognized a significant distinction, which bears directly upon the constitutional consequences, between conservation measures aimed directly at interstate purchasers and wholesale for resale, and those aimed at producers and production. 372 U.S. at 94.

Finally, the Court noted that Kansas had other alternative methods of checking waste with the text of Footnote 12, noting one method being "proration and similar order directed at producers." 372 U.S. at 95.

The KCC orders in Paragraph (p) have scrupulously adhered to this Court's analysis in *Northern*. The orders are directed at producers, not purchasers. It is unfortunate that the *Northern* rationale has removed from states the ability to order ratable takes from a field, because the only realistic method of protection of property rights left to a state with a field in an out-of-balance condition is to cancel underages and encourage production.[6] It is an economic fact that the purchasing, and consequently the production in the Hugoton Field is completely controlled by a few pipelines, in effect a monopsony. From the state's perspective sound conservation practices are at a

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[6] In an insightful article Prof. Martin has analyzed the legal and conservation implications of Northern, Transco and the case at issue, *Northwest Central v. KCC*. Martin argues that the *Northern* and *Transco* decisions improperly restricts the states in fulfilling their duty to protect correlative rights and prevent waste. While Prof. Martin's analysis provides a sound basis to revisit the *Northern* and *Transco* decisions, the issues at bar can be dealt with by merely restricting *Transco* and *Northern*. Martin, *Regulation of Gas Production Rates and Imbalances After Transco v. Oil & Gas Board*, 27 Washburn Law Journal, 298 (1988).

mercy, and controlled by the motives of these monopsony pipelines.[7]

It is undisputed that this order does not require, force or coerce Appellant to purchase one cubic foot of gas from the Hugoton Field, despite Appellant's rhetoric to the contrary. Appellant and other monopsony pipelines are causing field pressure fluctuations and drainage by electing to shut-in wells for extended periods of time. While using the Hugoton Field for vast storage of natural gas through the abuse of the Commission's rules on unlimited banking of underages may neatly fit into the overall strategy of a regulated monopoly, the effect on conservation in the Hugoton Field is devastating. The fact remains that compensating drainage requires production.

What is particularly disturbing about the *Northern* decision is that the Court majority did not look to any congressional intent to disrupt the state laws nor did the Court find any actual conflict between the state and federal programs. The Court found simply a potential conflict. In so doing, the Court's decision has had the effect of leaving interstate pipelines unfettered by either state or federal regulation as to prevention of waste, protection of correlative rights, or monopsony power. Thus was created a regulatory gap where it was the

[7] One of the purposes of the Natural Gas Act of 1938 was to regulate the monopoly powers of interstate pipelines which had been left unregulated because of the decision in *Missouri v. Kansas Natural Gas*, 265 U.S. 298 (1924). However, the control of monopsony power concerning conservation in oil and gas producing states was expressly left to the states in the Natural Gas Act.

express intent of the Natural Gas Act to leave no such gap. The problem in the Hugoton Field was and is drainage, not the level of allowables when compared to market demand. The solution chosen by the KCC merely modified the time allowed to produce accumulated underages, thus providing an incentive to production.

IV. THE KCC ORDER DOES NOT CONFLICT WITH FERC AUTHORITY

Appellant seeks to create a conflict between the KCC amendment to Paragraph (p) and NGA Section 7(b) and 7(c). 15 U.S.C. §717f(b)(c). Pursuant to the NGA the FERC has plenary authority over abandonment of natural gas reserves and certificate issues. However, Appellant overreaches when stating that the KCC order would "effectuate the permanent abandonment of natural gas reserves dedicated to interstate commerce." (Brief of Appellant, page 24). This type of created conflict is simply nonexistent.

The Paragraph (p) amendment does not, in any manner, deal with the Hugoton Field reserves. All of the reserves which were dedicated to Appellant before the amendment are dedicated to Appellant after the amendment. Rather, the KCC has merely cancelled old allowables which were assigned years ago. Of course, the old allowables are replaced with new, currently and calculated allowables commensurate with up-to-date information on field pressure and market demand. Furthermore, Appellant's argument presupposes a finding that drainage from a lease dedicated to interstate commerce is a *de facto* abandonment. Such is not the case. FERC has never

held, nor has Appellant cited any authority for the proposition that drainage of reserves from a lease dedicated to interstate commerce constitutes abandonment. FERC has stayed out of the arena of conservation, and respected the state's obligation to prevent waste and protect correlative rights.

At the very best, Appellant could argue that if the old allowables are cancelled then the producers' wells to which Appellant is connected will lose the opportunity to receive compensating drainage when the wells are produced. In the first place Appellant owns no interest in the minerals and has no correlative rights. Moreover, Appellant's argument flies on the face of the specific findings of the KCC. The KCC relied on testimony which stated that current uncompensated drainage if not corrected by timely production, then the shut-in wells might ultimately have their reserves drained away such that they would never receive compensating drainage. (J.A. at 36, 133-134). Indeed, in order for Appellant to receive all of the gas under its producers' leases, it should welcome the amendment to Paragraph (p).

V. KCC AMENDMENT DOES NOT VIOLATE THE COMMERCE CLAUSE

The standards of analysis of commerce clause challenges to state regulation are well settled by this Court. *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970); *Arkansas Electric Cooperative Corporation v. Arkansas Public Service Commission*, 461 U.S. 374 (1983). As a threshold matter there must be no discrimination against interstate commerce nor must there be a possibility of inconsistent

regulation by different states. Once the threshold questions are met, the analysis then turns to weigh the benefits of the KCC order on local conservation concerns against the minimal burdens on interstate commerce.

The amendment to Paragraph (p) meets the first threshold, even-handed regulation, in that all producers are equally bound by the order. As previously stated, the KCC order found that correlative rights were being violated now. According to the KCC order, Appellant's producers will not have an opportunity to receive compensating drainage due to the depletion of field energy resulting from the pressure imbalances that are in existence today. Next, the KCC order serves a legitimate local concern repeatedly recognized by this Court, the conservation of natural resources. *Champlin*, supra; *Northern*, supra. Appellant's argument that "the only competent evidence was that waste will be caused, not prevented . . . and correlative rights will be violated not protected by the order" (Appellant's Brief, page 34), is nothing more than a plea for this Court to reweigh the evidence presented before the KCC. Appellant failed to persuade the KCC of this position at the hearing. Appellant's attempt to have this Court reweigh the evidence should be rejected also.

Once the threshold questions are dealt with, the Pike test involves weighing the benefits of the KCC order against the burdens it allegedly places on interstate commerce. Thus, a question of perspective and balance is placed before this Court. Appellant argues that the KCC places a "substantial" burden on interstate commerce by reducing the requirements concerning cancelled underages. However, the KCC requirements on cancelled

underages are some of the most lenient requirements in the nation.[8] Indeed, it is simple truth that any state requirement concerning cancellation of underages, or for that matter any conservation practice concerning natural gas, will have some limited effect on purchasing practices and therefore interstate commerce.

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[8] A number of states have more stringent cancellation requirements than Kansas. For instance, pursuant to New Mexico Public Service regulation R-8170(b), a well can accumulate underages for one year, and once accumulated, the underages must be produced within one year. If the underages are not produced they are permanently cancelled. In Texas, pursuant to Texas Railroad Commission rule 31(h)(4) operators are allowed to accumulate underages in one balancing period (six months), and carry forward the underages to the next balancing period. If the underages are then not produced, the operator may then cancel the underages, with the cancelled underages being recalculated in the field allowable formula, or the Texas Commission can cancel the underages. Once cancelled, the operator can reinstate the underages either by filing signed waivers from all offset operators together with a waiver from the operators' purchaser, or through a hearing process. In Oklahoma, pursuant to Oklahoma Corporation Commission – OGR rule 2-320, a well can accumulate underages to a level equal to six times the January allowable. Underages which are then cancelled may be reinstated, either administratively within six months from the time the well reaches its maximum underage, or by hearing before the Commission. However, underages can only be reinstated once the well reaches an overproduced status. Furthermore, the well has only one year in which to produce the underages. Each of these states has conservation rules which are stricter than the Kansas rules, which allow for underages to be reinstated within three years, and produced within the following five years.

Finally, Kansas has no other method of protecting the Hugoton Field from the waste which is currently occurring. In *Northern* the Court removed ratable take orders as a tool the states could utilize, but pointed to other methods, including directing orders to producers. *Northern*, supra. The order clearly demonstrates that adjusting the allowable formula would not solve the problems in the Hugoton Field. Rather, the Commission found that only amending Paragraph (p) would benefit the Hugoton Field. There is no less intrusive method because there is no other method the KCC could use to achieve the results of preventing waste and protecting correlative rights.

CONCLUSION

For the above stated reasons the amici urges the Court to uphold the orders of the Kansas Corporation Commission.

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AMICUS CURIAE

BRIEF

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No. 86-1856

IN THE
Supreme Court of the United States
OCTOBER TERM, 1988

NORTHWEST CENTRAL PIPELINE CORPORATION,
Appellant,

v.

STATE CORPORATION COMMISSION OF KANSAS, *et al.*,
Appellees.

On Appeal from the Supreme Court of Kansas

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF THE COUNCIL OF STATE GOVERNMENTS, INTERNATIONAL CITY MANAGEMENT ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, U.S. CONFERENCE OF MAYORS, AND NATIONAL LEAGUE OF CITIES AS *AMICI CURIAE* IN SUPPORT OF APPELLEES

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Pursuant to Rule 36.3 of the Rules of this Court, *amici* respectfully move for leave to file the attached brief *amicus curiae* in support of appellees. Appellees have consented to the filing of this brief; their letter of consent has been filed with the Court. This motion is made necessary because appellant has denied consent.*

The *amici curiae*, organizations whose members include state, county, and municipal governments and officials throughout the United States, have a compelling

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* There were several other parties to the judgment below, but only appellant has appealed. Of the other parties below, Colorado Inter-

interest in legal issues that affect the powers and responsibilities of state and local governments.

This case presents another instance of interstate businesses invoking federal preemption and Commerce Clause arguments to invalidate legitimate state regulation. At issue is the control historically entrusted to the States of the production—as opposed to the interstate transportation and sale—of natural gas. The State of Kansas' Basic Proration Order, fixing production "allowables" for each well in the Hugoton Field, has been in effect for more than 40 years. The State Corporation Commission of Kansas, finding that underproduction was endangering sound recovery practices and correlative rights of operators that met their allowables, amended the order to require that production underages that had been permitted to accumulate had to be produced within a reasonable period of time.

Amici are concerned that appellant's preemption argument, based on the Natural Gas Act, would, if sustained, destroy the Act's reservation to the States of authority to regulate the "production or gathering" of natural gas. As the Solicitor General has conceded (see Brief for the United States And The Federal Energy Regulatory Commission As *Amici Curiae* at 8), enforcement of the amended order would not conflict with the discharge of the federal government's responsibilities under the Natural Gas Act.

Amici are also concerned about appellant's proposed extension of the Commerce Clause. State regulation that may affect the profitability of one or more interstate businesses does not for that reason alone discriminate against or unduly burden interstate commerce.

Invalidation of the Kansas regulation would affect the statutes, rules or orders of at least a dozen natural gas producing States. Because this Court's decision will have a direct effect on matters of prime importance to *amici* and their members, *amici* seek leave to file this brief in order to assist the Court in its resolution of the case.

Respectfully submitted,

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August 31, 1988

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state Gas Co., Graham-Michaelis Corp., Kansas Petroleum, Inc., Cabot Corp., Northern Pump Co., Panhandle Eastern Pipe Line Co., Southwest Kansas Royalty Owners Ass'n, Mesa Limited Partnership (formerly Mesa Petroleum Co.), and Amoco Production Co. have consented to the filing of this brief. Their letters of consent have been filed with the Clerk. We have also filed a letter from Northern Natural Gas Co. stating its position that it is not a party to this case. K N Energy, Inc., has denied consent.

QUESTION PRESENTED

Whether an order of the State Corporation Commission of Kansas limiting the time for reinstatement of "underages" below monthly production allowables is preempted by the Natural Gas Act or violative of the Commerce Clause.

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**BRIEF OF THE
COUNCIL OF STATE GOVERNMENTS,
INTERNATIONAL CITY MANAGEMENT ASSOCIATION,
NATIONAL ASSOCIATION OF COUNTIES,
U.S. CONFERENCE OF MAYORS, AND
NATIONAL LEAGUE OF CITIES
AS *AMICI CURIAE* IN SUPPORT OF APPELLEES**

INTEREST OF THE *AMICI CURIAE*

The interest of *amici* is set forth in the motion accompanying this brief.

INTRODUCTION AND STATEMENT OF THE CASE

A. The Historical Background

1. This case involves an amendment to a 1944 proration order of the State Corporation Commission of Kansas ("KCC") regulating the production of natural gas in the Kansas portion of the vast Hugoton Field.

Gas proration is implemented by the establishment of so-called "allowables". Allowables are the maximum vol-

ume of gas that may be produced during a given period from each well in a common source of gas supply (such as a gas field or reservoir) (J.S. App. 111a-12a, 114a, 118a-19a, 121a-25a). When an operator produces more than its allowable, the producer accumulates an "overage"; correspondingly, to the extent that less than the allowable is produced, the producer accumulates an "underage" (*id.* at 118a, 123a). As part of the traditional state regulation of gas production, well operators are permitted, within certain limits, to decrease or increase production relative to their allowables as a means to eliminate accumulated overages or underages and therefore to return to a general state of balance (*e.g.*, *id.* at 123a-25a). *See Northern Natural Gas Co. v. State Corporation Comm'n of Kansas*, 372 U.S. 84, 94-95, n.12 (1963) ("*Northern Natural*").

The need for proration arises from the fact that "[g]as flows from high pressure areas to low pressure areas" (J.S. App. 17a), and that a well's pressure falls when it is produced (*id.* at 17a-18a). "Thus, one well can drain an entire pool, even if the gas in the pool is owned by several different owners" of different wells completed in the pool. *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Bd.*, 474 U.S. 409, 412 (1986) ("*Transco*"). "The interests of these other owners often are referred to as 'correlative rights'" (*id.*).

2. The Court has long recognized the legitimate right of States to regulate the production of gas wells to protect the correlative rights of producers in a common pool. In 1932, the Court upheld the constitutionality of a state proration order as a means to effect conservation of these resources. *Champlin Refining Co. v. Corporation Comm'n of Oklahoma*, 286 U.S. 210, 235 (1932).

In 1938, Congress enacted the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717-717z, authorizing the Federal Power Commission ("FPC") (now the Federal

Energy Regulatory Commission ("FERC")) to regulate "natural-gas companies." In that legislation, Congress went out of its way not to disturb the States' authority to regulate natural gas production. In this regard, Congress specifically provided that the NGA "shall not apply * * * to the production or gathering of natural gas." Section 1(b), 15 U.S.C. § 717(b). *See Federal Power Comm'n v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 513 (1949) (footnotes omitted). In 1954, the Court held in *Phillips Petroleum Co. v. State of Wisconsin*, 347 U.S. 672, that sales for resale in interstate commerce made by independent gas producers did not fall within the "production or gathering" exemption, but were within the jurisdiction of the FPC.

3. In *Northern Natural*, *supra*, the Court invalidated orders of the KCC that required an interstate pipeline to purchase gas ratably from wells connected to its system within Kansas. The Court found that the KCC orders at issue were not limited to the regulation of "production or gathering" as those terms are used in the Section 1(b) exemption of the NGA. 372 U.S. at 89. The Court was concerned that the ratable take orders directed at interstate pipelines "could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other states" (*id.* at 92). Hence, the Court found that the KCC orders were preempted by the NGA. The Court also noted that Kansas had "alternative means of checking waste and disproportionate or discriminatory taking," for example, "proration and similar orders directed at producers" (*id.* at 94 & n.12). *See also Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179, 185 (1950) ("a state may adopt reasonable regulations to prevent economic and physical waste of natural gas").

4. Congress subsequently enacted the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301-3432, which, in effect, modified the *Phillips Petroleum Co.* decision by substantially limiting FERC's authority under the NGA over wellhead sales of gas. *Transco, supra*, raised the question whether the NGPA reversed the Court's holding in *Northern Natural* with respect to deregulated "high cost" gas. The Court concluded that its holding in *Northern Natural* was unaffected by the passage of the NGPA.

In *Transco*, the Court reasoned that "Congress, in revising a comprehensive federal regulatory scheme to give market forces a more significant role in determining the supply, the demand, and the [wellhead] price of natural gas, [had not] intended to give the States the power it had denied FERC." 474 U.S. at 422. The case involved Mississippi ratable take orders, which, like the KCC orders at issue in *Northern Natural*, were expressly directed at purchasers (interstate pipelines). The Mississippi orders were therefore preempted by the federal regulatory scheme of the NGA and the NGPA (*id.* at 422-25).

B. The KCC Order

For decades, the KCC has regulated the production of gas from the hundreds of wells in the Kansas portion of the vast Hugoton Field (J.S. App. 65a). Since 1944, the KCC's consistent policy has been that "[w]henever the available production from the common source of supply [in the Hugoton Field] is in excess of the market demand . . . a producer is allowed to produce only a portion of the gas that may be produced without waste and to satisfy the market demand and to currently produce proportionately with other developed leases" (*id.* at 67a). See also Kan. Stat. Ann. § 55-703.

In the Basic Proration Order for the Hugoton Field, the KCC placed limits on the accumulation of "underages": if a well accumulated underages greater than a

stipulated level (depending on the production capability of the well), the underage would be cancelled; however, the underage would be reinstated if the producer could demonstrate at any time in the future that the well was physically capable of producing above its allowable—thus able to be in "an overproduced status"—and that the producer had a market for the increased production. See generally J.S. App. 68a; see also Subsequent Commission Orders Amending Paragraph (P), Appendix C to Brief of Appellees.

The KCC became concerned about the extent of underproduction in the Kansas Hugoton Field and, in March 1982, began an investigation to determine whether there was a need for revision of the Basic Production Order (J.S. App. 20a). The KCC found that by September 1982 the Hugoton Field had an underage of 204.5 billion cubic feet (Bcf), as compared to an underage of 144.5 Bcf a year earlier. Between January 1, 1967, and August 1, 1982, 508 Bcf of underages had been cancelled, and 194 Bcf had been reinstated (*id.* at 19a).

Because cancelled underages could accumulate indefinitely without any adverse regulatory effect, purchasers were using the Kansas Hugoton Field for "storage," and were purchasing gas elsewhere for immediate use. This "forced . . . production below good recovery practices and upset the dynamics of the Hugoton Field, affecting both proration and correlative rights" (*id.* at 4a).

For example, the KCC was concerned that a producer with a large accumulated underage that later found a market for its gas could, by having its underages reinstated, overproduce from its wells and thereby cause drainage to the producers whose wells were consistently producing at allowable levels (*id.* at 75a-76a, 89a-90a). The KCC found that this potential drainage problem was exacerbated by the fact that "[t]hose operators producing their allowables may have wells with lower pressures than the average wells in the field and consequently may

receive a smaller allowable than those operators not producing their allowables" (*id.* at 73a).

Accordingly, after investigation and hearing, in order to protect the correlative rights of those producers that were meeting their allowables and to "prevent unreasonable discrimination in favor of or against any one producer in the field," the KCC determined that the "prescribing of reasonable periods of time in which these allowables must be produced is as important as the assignment of the allowables in the first instance" (*id.* at 88a-89a), and amended Paragraph (P) of the Basic Proration Order.

The amendment provided that (a) any underage cancelled before January 1, 1975, could be reinstated only by application made on or before December 31, 1983; (2) reinstatement of any underage cancelled between January 1, 1975, and December 31, 1982, must be requested by December 31, 1985; (3) reinstatement of any underage cancelled after December 31, 1982, must be requested within three years from the date of cancellation; and (4) to obtain reinstatement of any underage cancelled after 1974, the well must be physically capable of being in an overproduced status (*id.* at 20a-21a, 77a-80a; and see Subsequent Commission Orders Amending Paragraph (P), Appendix C to Brief of Appellees). A producer was given sixty months to produce the reinstated underage (*id.* at 21a). If any underage was not reinstated or produced within the time prescribed, it would be permanently cancelled (*id.* at 79a). The reinstatement deadlines have been twice extended. See Subsequent Commission Orders Amending Paragraph (P), Appendix C to Brief of Appellees.

C. Decisions Below

The District Court of Gray County, Kansas, affirmed the KCC's amendment of the Basic Proration Order in all respects (J.S. App. 53a-62a). Dismissing appellant's claim that the amendment to Paragraph (P) was pre-

empted by the Natural Gas Act, the district court held that because "this K.C.C. Order deals with the producers of natural gas it falls within the specific exemption" that "allows the State to regulate the 'production or gathering' of natural gas" (*id.* at 59a).

The Kansas Supreme Court also affirmed the KCC order in all respects. The court reviewed in detail the evidence gathered by the KCC and cited, in particular, the evidence that "the accumulation of underages in the Hugoton Field had rendered the field so out of balance it was seriously impairing the correlative rights of the landowners and operators" (*id.* at 32a). The court therefore found that "there was substantial competent evidence to support the KCC's conclusion that correlative rights were being compromised by the excessive underages" (*id.* at 37a-38a). See also *id.* at 18 ("When the larger allowable and underage is produced, the well's pressure drops below the other wells and compensatory drainage occurs").

The court rejected appellant's preemption argument, finding that the KCC's amended "rules on underages are a part of production regulation and thus are not violative of the federal [Natural Gas] act, even though purchasers are indirectly caught in the backwash" (*id.* at 41a). The court also rejected appellant's argument that "the problem was caused by the KCC because it ignored the current market demand and set the allowables too high" because "the allowables were not appealed and [were] thus not at issue." (*id.* at 26a).

On appellant's appeal, this Court remanded the case to the Kansas Supreme Court for reconsideration in light of the decision in *Transco*. On remand, the Kansas Supreme Court concluded, as before, that the KCC order was directed at gas producers, not purchasers, and thus properly fell within the production and gathering exemption of Section 1(b) of the NGA. The court also found that the KCC had properly focused its order in a way

"necessary for the prevention of waste and the protection of correlative rights" (J.S. App. 11a-12a) and that it was not "primarily directed at the marketing of gas rather than the production thereof" (*id.* at 11a). The Kansas Supreme Court therefore affirmed the KCC order in all respects.

SUMMARY OF ARGUMENT

I. The KCC's amendment of its Basic Proration Order setting time limits for the reinstatement and production of underages is not preempted by the NGA because it is an exercise of the authority specifically reserved to the States by that Act. In Section 1(b) of the NGA, Congress specifically excluded "production or gathering" from the comprehensive federal scheme of natural gas regulation over wholesale sales and transportation. The KCC order pertains not to "wholesale sales and transportation of natural gas in interstate commerce" under the federal scheme, but to the regulation of "production" reserved to the States. This Court's decisions have consistently recognized state authority under the "production or gathering" exemption.

There is no conflict between the challenged amendment and the exercise of FERC's jurisdiction over sales of natural gas for resale in interstate commerce. The KCC order is directed only to producers, not to purchasers. Any effect on the purchasing decisions of interstate pipelines results not from the order itself, but from the pipelines' own economic choices, freely made. The KCC order provides Hugoton producers with the opportunity to produce a fair share of gas needed to meet projected market demand. These producers can comply with both the KCC order and the NGA. Appellant remains free to purchase or not to purchase Hugoton gas. The KCC order will not result in the permanent loss of gas reserves.

The KCC order is based on the KCC's finding that production by various operators in the Hugoton Field in recent years has fallen into severe imbalance and that

measures should be taken to protect the correlative rights of all producers in the Hugoton Field. Accordingly, the KCC order is not an exercise of authority that Congress placed in the hands of FERC. Rather, it is an exercise of a legitimate state function that does not conflict with the federal scheme.

The KCC order is consistent with this Court's holdings in *Northern Natural* and *Transco*. Unlike the orders at issue in those cases, the KCC order is directed at producers, not purchasers, and thus falls squarely within the "production or gathering" exemption in Section 1(b) of the NGA. The KCC order does not place appellant in the dilemma of being required to purchase more Kansas gas than it needs or risk liability for breach of any contract. The KCC order does not create any criminal or civil penalty for failure to purchase gas from the Hugoton Field. Rather, the KCC order is precisely the "alternative means of checking waste and disproportionate or discriminatory taking" commended by the Court to the KCC in lieu of ratable take orders in *Northern Natural*.

The KCC order is supported by *Transco*, which referred to the pro-competitive policies of the NGPA. The KCC order ensures that all producers in the Hugoton Field can produce enough gas to meet their market demands. It also ensures that all Hugoton producers have the opportunity to sell gas in a free market environment based on *existing* conditions, and precludes sellers from accumulating rights to produce excessive levels of gas in the *future* at the expense of other producers.

II. Even before the NGA, the Court held that state proration orders directed at the production of natural gas were valid regulations under the Commerce Clause. *Champlin Refining*, *supra*; *Cities Service Gas Co.*, *supra*. Congress enacted the NGA to provide federal regulation in those areas where the Court had ruled that the States were not empowered to act, and preserved existing state

authority. When Congress has acted, the dormant Commerce Clause is no longer in question; Congress has exercised its power under the active Commerce Clause and has thereby determined the extent to which States remain free to regulate.

In any event, the KCC order should be sustained under this Court's dormant Commerce Clause jurisprudence. By its own terms, the KCC order does not discriminate. It applies evenhandedly to producers selling gas to consumers within the State and those selling gas to interstate markets. Any discrimination arises not from the order, but from economic conditions that presently make it undesirable for interstate pipelines to purchase Kansas gas.

Plainly, the KCC order does not unduly burden interstate commerce. Indeed, it does not burden commerce at all. It is not directed at the interstate wholesale or transportation of natural gas, but only at the extraction of the gas from the ground.

ARGUMENT

I. THE KCC ORDER IS NOT PREEMPTED BY THE NATURAL GAS ACT.

A. Congress Did Not Intend To Preempt State Regulation Of The Production Of Natural Gas.

The Court's most recent preemption analysis of natural gas regulation is found in *Schneidewind v. ANR Pipeline Co.*, 108 S. Ct. 1145 (1988). In that case, which held that the NGA preempted a Michigan law regulating securities issuances by natural gas companies, the Court reaffirmed (108 S. Ct. at 1149-50) that:

> The NGA long has been recognized as a "comprehensive scheme of federal regulation of 'all wholesales of natural gas in interstate commerce.'" *Northern Natural Gas Co. v. State Corporation Comm'n of Kansas*, 372 U.S. 84, 91 (1963), *quoting Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 682 (1954). The NGA confers upon FERC exclusive jurisdiction over the transportation and sale of natural gas in interstate commerce for resale. *Northern Natural Gas Co.*, 372 U.S., at 89.

The Court recognized, however, that the comprehensiveness of the federal scheme did not end the inquiry. The NGA does not preempt "every state statute that has some indirect effect on rates and facilities of natural gas companies." *Schneidewind*, 108 S. Ct. at 1155. Rather, the question was whether the Michigan law "regulates *within* this exclusively federal domain" of "matters relating to wholesale sales and transportation of natural gas in interstate commerce." 108 S.Ct. at 1153 (emphasis in original). In *Schneidewind*, the decisive factor was that the "central purpose" of the state law was "to regulate matters that Congress intended FERC to regulate," and that "the NGA has equipped FERC adequately to address" (*id.* at 1155).

The KCC order at issue here pertains not to "wholesale sales and transportation of natural gas in interstate commerce," but to the "production" of gas, which Congress explicitly exempted from the sweep of the NGA.[1] This Court's decisions under the NGA have consistently referred to the exemption as a measure of the scope of the authority conferred initially upon the FPC and now upon FERC.

The comprehensive federal regulatory scheme established by Congress for the natural gas industry was intended to complement the existing state scheme of regulation. *See Public Utilities Comm'n of Ohio v. United Fuel Gas Co.*, 317 U.S. 456 (1943). The NGA was en-

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[1] Section 1(b), 15 U.S.C. § 717(b) expressly provides that the Act "shall not apply . . . to the production or gathering of natural gas."

acted to fill a regulatory gap that existed because several decisions of this Court had held that the States could not regulate interstate sales of natural gas. *See Panhandle Eastern*, 337 U.S. at 502-03 ("[Congress] contemplated the exercise of federal power as specified in the Act, particularly in the interstate segment which the states were powerless to regulate because of the Commerce Clause"); *see also Interstate Natural Gas Co. v. Federal Power Comm'n*, 331 U.S. 682, 690 (1947); *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U.S. 498, 506 (1942).

The NGA was never intended to "intrude on the domain traditionally reserved for control by state commissions; and the FPC was given no authority over 'the production or gathering of natural gas.'" *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 612-13 (1944). *See also Interstate Natural Gas Co.*, 331 U.S. at 690; *Colorado Interstate Gas Co. v. Federal Power Comm'n*, 324 U.S. 581, 602 (1945). The Natural Gas Act "expressly exempts from its coverage . . . the production and gathering of natural gas." *Panhandle Eastern*, 337 U.S. at 504.

Indeed, "[t]here is no doubt that the States do possess power to allocate and conserve scarce natural resources upon and beneath their lands." *Northern Natural*, 372 U.S. at 93. This Court has "recognized such power with particular respect to natural gas." *Id.*, *citing Patterson v. Standard Oil & Gas Co.*, 305 U.S. 376 (1939); *Bandini Petroleum Co. v. Superior Court*, 284 U.S. 8 (1931); *Walls v. Midland Carbon Co.*, 254 U.S. 300 (1920). The Court recognized the fixing of allowables as a prerogative of the States before the enactment of the NGA. *Champlin Refining Co.*, 286 U.S. at 210. The NGA was meant "to supplement state power and to produce a harmonious and comprehensive regulation of the industry. Neither state nor federal regulatory body was to encroach upon

the jurisdiction of the other." *Panhandle Eastern*, 337 U.S. at 513 (footnotes omitted).

If the KCC order were overturned, there would be little left for Kansas and other States to do to regulate production from the gas fields within their borders in order to protect the correlative rights of producers, as well as to prevent the waste of natural gas. In Appendix A we list States that have enacted laws limiting the production of natural gas in a manner that is similar to the Kansas law. If appellant prevails despite the "production or gathering" exemption of the Natural Gas Act, state regulation of gas production throughout the United States would be seriously jeopardized, if not eliminated.

The KCC order at issue here is an appropriate exercise of the State's authority to regulate gas production that is excluded from the comprehensive federal regulatory scheme. Accordingly, it is not preempted.

B. The KCC Order Regulating Natural Gas Production Underages Does Not Conflict With Federal Jurisdiction.

Appellant does not seriously argue that the KCC lacks authority to establish allowables for gas production in the Hugoton Field. Its contention, rather, is that the KCC may not enforce adherence to these allowables by setting time limits on the reinstatement and production of underages because those time limits adversely affect interstate pipelines and therefore conflict with the NGA. The allowables and the KCC order, however, are directed not at purchasers of natural gas for interstate transmission, but at the "production" activities of the producers from the common pool of the Hugoton Field. Thus, the KCC order falls clearly within the language of Section 1(b) of the NGA and outside the federal regulatory scheme.

1. *The KCC order furthers the legitimate state interest in gas production that the federal government does not regulate.*

Both before and after enactment of the NGA, the Court upheld the constitutionality of state orders prorating oil and gas production from wells drawing from a common source in order to conserve these resources. *Champlin Refining Co.*, 286 U.S. at 235; *Cities Service Gas Co.*, 340 U.S. at 185. By its own terms, the KCC order regulates only the *production* of natural gas in order to encourage good recovery practices and protect the correlative rights of gas producers in the Hugoton Field (J.S. App. 72a-73a, 75a, 79a-80a).

The Kansas legislature has empowered the KCC to regulate the production of natural gas in Kansas. Under Kansas law, the KCC is charged with the duties "to prevent waste, to further the conservation of oil and gas, and to protect the correlative rights of persons entitled to share in the production thereof." Kan. Stat. Ann. § 55-1301. The KCC is directed to prevent inequitable or unfair taking of natural gas and to prevent unreasonable discrimination in favor of or against any producer. Kan. Stat. Ann. § 55-703.

In performing its statutory duties, the KCC became concerned about the large underages that were accumulating because of a lack of market demand for a portion of the gas from the Hugoton Field. The KCC's 1982 investigation of these underages led it to conclude that "the extreme tolerance provisions of the Proration Order" reduced the "incentive to produce" (J.S. App. 73a). As a result, "some operators" were being deprived of "the opportunity to participate in the given market" because (1) their wells could be drained in the future by other operators producing excessive underages (*id.* at 75a-76a, 89a-90a), and (2) the lower pressure in wells that consistently produce their allowables would result in their receiving a smaller allowable than underproduced wells (*id.* at 73a).

As the Kansas Supreme Court found, there was substantial evidence to support the KCC's conclusion that correlative rights were being compromised by the excessive underages (*id.* at 37a-38a). The court noted that "the amended order provides each producer an opportunity to reinstate its cancelled underages and thus the right to ultimately recover the gas under its leases" (*id.* at 26a), and found that its purpose was not to restrict production of gas but to encourage it (*id.* at 37a). Any effect on interstate sales was "merely incidental rather than the objective of the order" (*id.* at 12a).

The KCC order provides producers the opportunity to produce their fair share of the gas to meet projected market demand; it cannot force all producers and their purchasers to take advantage of this market opportunity. Appellant remains free both before and after the KCC order to purchase or not to purchase gas from the Hugoton Field. Moreover, Kansas producers with interstate purchasers obviously can comply with both the KCC order and the NGA. Thus, there is no possibility of a collision between state and federal law. As the "production or gathering" exemption makes clear, the NGA was meant to supplement, not to disrupt, state authority over gas production and to provide a comprehensive regulatory scheme.

2. *The KCC order does not conflict with the abandonment provisions of the Natural Gas Act.*

Appellant asserts (App. Br. 17) that the KCC order conflicts with FERC's authority under Section 7(b) of the NGA to control abandonment.[2] Appellant makes two arguments: (1) drainage of gas as a result of cancelled

[2] Section 7(b) of the NGA states that "no natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of [FERC], or any service rendered by means of such facilities, without the permission and approval of [FERC] . . . ." 15

underages would constitute an unlawful abandonment, and (2) the FPC issued certificates to appellant's predecessor based on a certain level (which appellant does not define) of reserves that would be unlawfully abandoned as a result of the KCC order (App. Br. 24-28). Neither claim has any merit.

a. The KCC order does not create *de facto* abandonment. If the setting of allowables is a proper state function, the State must also have authority to establish the acceptable limit of underages and overages. Otherwise, the allowables would have no meaning; underages can only be reduced when the producer exceeds the allowable limit and produces overages.[5]

The KCC order does not permanently cancel gas production underages. Rather, it provides "a reasonable opportunity to reinstate and produce a cancelled underage before such underage is permanently cancelled" (J.S. App. 74a). Underages cancelled after 1982 may be reinstated within three years after the date of cancellation, and five years are allowed for production of reinstated underages. Even these reasonable limits have been extended by the KCC. See Subsequent Commission Orders Amending Paragraph (P), Appendix C to Brief of Appellees. In addition, the loss of underages will not necessarily reduce the amount of reserves that appellant's suppliers are entitled to recover. Shut-in or underproduced wells will continue to receive higher allowables than wells that are continuously producing their allowables (*cf.* J.S. App. 73a). Thus, appellant may be able to re-

U.S.C. § 717f(b). *See United Gas Pipe Line Co. v. Federal Power Comm'n*, 385 U.S. [illegible] (1966).

[3] Appellant also ignores the fact that drainage of chronically underproduced wells would continue to occur even in the absence of the KCC order regulating underages. If certain producers fail to produce gas while others continue to produce, drainage will occur naturally. Under appellant's argument, even naturally occurring drainage would amount to *de facto* abandonment.

ceive more gas in the future even if the underages are cancelled.[4]

b. Appellant's additional contention that the FPC "re-li[ed] on the availability of sufficient Kansas-Hugoton reserves before issuing a certificate" to appellant's predecessor (App. Br. 27), *citing Cities Service Gas Co.*, 24 FPC 1127, 1135 (1960), is insubstantial. The certificate was issued *in 1960*, and the FPC estimated at the time, on the basis of a geological study, that the reserves in the Hugoton Field would provide full availability for approximately *twelve years* (or until 1972). *See Cities Service Gas Co.*, 24 FPC at 1133-34.[5] The FPC also envisioned that the twelve-year availability would require future development of reserves from the Hugoton Field. Clearly, the FPC did not rely on the availability of unlimited reserves in the Hugoton Field from which appellant could draw natural gas at will.

C. The *Northern Natural* And *Transco* Decisions Do Not Support Appellant's Position.

Appellant also contends that "the KCC order here transgresses upon the same policies that led this Court to overturn [a] prior KCC order in *Northern Natural* and a similar Mississippi order in *Transco*" (App. Br. 22). This contention, however, overstates the holdings of these cases and thus does not withstand scrutiny.

[4] Appellant cites *Cities Service Gas Co.*, 38 FPC 364, 371, 377 (1967), to support its claim that the agency specifically considered the existence of large underages accumulating in the Hugoton Field and the resulting drainage potential. But nowhere in the order did the FPC even intimate that such underages and drainage constituted an abandonment. Moreover, the legal control of the FPC (and now FERC) over abandonment is subject to "physical problems beyond its control." *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 537 (1979), *quoting Sunray Mid-Continent Oil Co. v. Federal Power Comm'n*, 364 U.S. 137, 158 n.25 (1960). Consequently, drainage alone cannot constitute an abandonment.

[5] Indeed, in 1965 appellant's predecessor estimated a deliverability life of only 12 or 13 years (to 1977 or 1978) from its Hugoton Field reserves. *See Cities Service Gas Co.*, 38 FPC at 373.

As noted, *Northern Natural* involved a KCC order requiring interstate pipelines to purchase gas ratably from various producers in the Hugoton Field.[6] The order was "unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce." 372 U.S. at 92 (emphasis in original). Indeed, the interstate purchasers were faced with criminal penalties for not complying with the KCC order (*id.* at 92). The prior KCC order presented the interstate pipeline purchaser with a Hobson's choice: "taking more gas from Kansas than it could currently use . . . o[r] risking liability for a breach of . . . contract by decreasing its takes from [certain] wells below the allowables" (*id.* at 89; footnote omitted).

The KCC order here imposes no such dilemma upon appellant. The order on its face is aimed at Kansas producers, not interstate purchasers (J.S. App. 67a-68a). Appellant is not faced with any penalties, much less criminal penalties, as a result of the KCC order. Appellant is not legally compelled to take more Hugoton gas than it needs or to risk liability for breach under any contracts to buy gas from other producers. At most, appellant is faced with an economic decision whether to purchase Hugoton gas or gas under other contracts.

The KCC order at issue, in contrast to the KCC order in *Northern Natural*, is intended to regulate the production of gas from the Hugoton Field to protect correlative rights and to prevent waste. By providing that underages cannot be accrued indefinitely and produced at any time, the KCC order encourages, but does not

[6] The KCC order in *Northern Natural* provided that "each *purchaser* shall take gas in proportion to the allowables from all wells to which it is connected and shall maintain all such wells in substantially the same proportionate status as to overproduction or underproduction." 372 U.S. at 86 n.1 (emphasis added).

compel, producers to increase production of Hugoton gas.

Accordingly, the KCC order restricting the reinstatement of underages is precisely the kind of "alternative means of checking waste and disproportionate or discriminatory taking" that this Court commended to the KCC in *Northern Natural*. *See* 372 U.S. at 94 n.12 (noting the "availability of regulatory alternatives, particularly in the form of proration and similar orders directed at producers" and that "it has been argued that the very objectives sought to be achieved here may be achieved through ratable production orders"). Thus, appellant's argument that any state order that "influence[s] the gas decisions of interstate pipelines" violates the holding in *Northern Natural* (App. Br. 29) sweeps far too broadly. Indeed, appellant's assertion robs the "production or gathering" exemption of Section 1(b) of the NGA of all meaning.[7]

For these same reasons, the KCC order does not conflict with the Court's holding in *Transco*, which involved a ratable take order "virtually identical" to the KCC order in *Northern Natural*. 474 U.S. at 411.[8] As the Court stated, "[i]f [Mississippi's] action were analyzed under the standard used in *Northern Natural*, it clearly would be pre-empted" (*id.* at 417). The only question presented in *Transco*, therefore, was whether the enactment of the NGPA "effectively nullified *Northern*

[7] Appellant's argument undercuts the basis of the Court's holding in *Northern Natural*. By arguing that the regulation of production is the equivalent of regulation of pipelines, appellant questions the very distinction that led the Court to find federal supremacy in that case. *See, e.g.*, 372 U.S. at 98 (Harlan, J., dissenting).

[8] The Mississippi order under review in *Transco* provided that "[the pipeline] shall ratably take and *purchase* without discrimination in favor of [one group of operators] against [another group of operators]." 474 U.S. at 414 n.1 (emphasis added).

Natural" (*id.* at 411). Because the KCC order does not conflict with *Northern Natural*, it perforce cannot conflict with *Transco*. In fact, the KCC order is supported by *Transco*.[9]

The Mississippi ratable take order in *Transco* was held to conflict with the federal scheme of market-oriented regulation of wellhead sales of "high cost" natural gas established in the NGPA. 474 U.S. at 422. The Court found that the enactment of the NGPA, which removed from FERC the regulation of high cost gas was not intended to restore regulatory authority over those sales to the States (*id.*)

Encouragement of a free market at the wellhead is precisely what the KCC order at issue here achieves. The allowables set by the KCC roughly ensure that all producers, both those selling to Kansas purchasers and those selling to interstate pipelines, are able to meet market demand. Intrastate sellers, facing a stronger demand for their commodity, may produce sufficient supplies to meet that demand. In addition, the KCC order encourages sellers to the interstate market to create a demand for their gas under *existing* market conditions. It places reasonable limits on a producer's ability to accumulate rights to produce excessive levels of gas in the

[9] The Court recently clarified that:

> *Transcontinental* was not meant to announce a new rule of burden-shifting whenever the Federal Government terminates or reduces its regulation of a field of commerce, replacing the normal need for finding a federal intent to preempt with a need to find a federal intent to retransfer authority to the States. To the contrary, a "clear and manifest purpose" of preemption is always required.

Puerto Rico Dep't of Consumer Affairs v. Isla Petroleum Corp., 108 S. Ct. 1350, 1355 (1988). Where, as here, Congress added a specific provision, Section 1(b), to the NGA to *prevent* the federal government from regulating gas production, and thus to *preserve* state jurisdiction over natural gas production, Congress has expressed its intent to allow state regulation to continue.

future and thereby disrupt the production of other sellers through excessive drainage.

In contrast, appellant seeks to escape the responsibilities and consequences of the free market by attempting to hoard gas when current interstate market demand is low and to increase production of Hugoton gas above the level of allowables when demand returns. This attempt to insulate pipelines from the effects of a free market for gas production would impair the rights of sellers that have consistently produced their allowables in the current market and thus undermine the pro-competitive policies of the NGPA that formed the basis of the Court's holding in *Transco*.

To be sure, *Transco* involved new "high-cost" gas (474 U.S. at 411), while the Hugoton gas may be primarily "old gas" (App. Br. 7) and thus still subject to limited FERC regulation. See, *e.g.*, NGPA §§ 104(b)(1) and 601(a)(1), 15 U.S.C. § 3315(b)(1) and § 3431(a)(1). Consistent with the congressional intent underlying the NGPA, however, FERC has exercised its NGPA authority and raised the price ceiling applicable to old gas in order to allow it to be priced at market levels.[10] FERC has also granted producers of old gas the right to sell the gas to new markets if the interstate pipeline purchasers agree to release the gas or refuse to pay mar-

[10] *See* FERC Order No. 451, 51 Fed. Reg. 22,168, 22,177 (June 18, 1986), *reh'g granted in part and denied in part*, Order No. 451-A, 51 Fed. Reg. 46,762 (Dec. 24, 1986), *further reh'g granted in part and denied in part*, Order No. 451-B, 52 Fed. Reg. 21,669 (June 9, 1987), *appeal pending sub nom. Mobil Oil Exploration & Producing Southeast, Inc. v. FERC*, No. 88-4940 (5th Cir.), *codified at* 18 C.F.R. §§ 270.201 and 271.402(c)(7) (1988); see particularly, 18 C.F.R. §§ 270.201(a)(2), 270.201(b)(1)(i) (1988). FERC raised the price ceiling of "old gas" to $2.73 per MMBtu for July 1988. See 18 C.F.R. § 270.101. The spot market price of gas during the same period was in the $1.50 per MMBtu range. See *Natural Gas Week*, at 12 (July 4, 1988).

ket prices for the gas.[11] Thus, the federal agency chosen to administer the NGPA has fostered the pro-competitive policy of the NGPA by encouraging the production of both old and new gas at market-clearing levels. The KCC order is consistent with those pro-competitive policies, noted in *Transco*.[12]

II. THE KCC ORDER DOES NOT VIOLATE THE COMMERCE CLAUSE.

In *Champlin Refining Co. v. Corporation Comm'n*, 286 U.S. at 235, the Court rejected a Commerce Clause challenge to a proration order imposed to prevent waste in the production of natural gas. "Such production is essentially a mining operation, and therefore is not a part of interstate commerce, even though the product obtained is intended to be and in fact is immediately shipped in such commerce." *Id.* In the more than fifty years since the *Champlin* decision, this Court has not modified this holding. *Champlin* thus stands as a formidable barrier to appellant's Commerce Clause challenge to the KCC order, which similarly regulates production.

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[11] *See* FERC Order No. 451, *supra*, 51 Fed. Reg. at 22,177-78; 18 C.F.R. § 270.201(f)(5) (1988). *See also Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987) (FERC market-oriented gas transportation program approved, but vacated on other grounds), *cert. denied, Interstate Natural Gas Ass'n v. FERC*, 108 S.Ct. 1468 (1987); FERC Order No. 500, 52 Fed. Reg. 30,334 (August 14, 1987), *appeal pending, American Gas Ass'n v. FERC*, No. 87-1588, *et al.* (D.C. Cir.).

[12] Appellant's further suggestion that the KCC should be required to reduce the allowables applicable to wells producing in the Hugoton Field (App. Br. 30 n.25, 35) would also frustrate the pro-competitive policies of the NGPA. Such a position discriminates against operators that consistently produce Hugoton gas at the level of current allowables to meet their markets. See *supra*, p. 21. Moreover, appellant's argument is precluded by its failure to appeal the relevant KCC orders setting the allowables. Indeed, the proper level of production allowables is a state question, not a constitutional question, which appellant should have challenged, if at all, under the relevant state principles.

Appellant's argument proceeds in apparent disregard of *Champlin*, which it does not even cite. Instead, it relies on more general concepts from other regulatory contexts. Although the precise nature of appellant's Commerce Clause challenge is difficult to discern, it is clear that the KCC order is valid under the Commerce Clause.

A. The KCC Order Does Not Discriminate Against Interstate Commerce.

The KCC order is not discriminatory within the meaning of this Court's decisions. The Court has held that "state statutes that clearly discriminate against interstate commerce are routinely struck down * * * unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism." *New Energy Co. of Indiana v. Limbach*, 108 S.Ct. 1803, 1807 (1988) (citations omitted). *See also City of Philadelphia v. New Jersey*, 437 U.S. 617, 623-24 (1978). Appellant's claim of discrimination appears to turn on its view that the KCC order is economic protectionism. "The admitted purpose of the amendment to paragraph (p) is to force interstate pipelines to take more gas from Kansas and less from other states upon penalty of losing their gas to the intrastate market" (App. Br. 32).[13] Appellant's submission is flawed in its premise as well as in its conclusion.

First, the Kansas Supreme Court twice specifically rejected the submission that the order was intended to regulate purchasers and not production (J.S. App. 11a-12a, 40a-41a). The court described the KCC's order as "a part of the Commission's authority to prorate and control production to prevent economic and physical waste and to protect correlative rights" (*id.* at 11a). Even to

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[13] For the KCC order's "admitted purpose," appellant relies upon the isolated statement of a single KCC staff witness: "Q. But what you simply are doing is trying to provide some incentive that the purchasers will take this underage, given the limited market? A. That's correct." (J.S. App. 50a).

the extent that production was encouraged (*id.* at 27a), it was in order to protect correlative rights, which are compromised by excessive underages (*id.* at 37a-38a).[14]

Second, appellant argues that limiting the right to reinstate underages is discriminatory because the allowables of its suppliers are too high and that the KCC order will result in cancellation of underages whose later reinstatement would compensate for the discrimination (App. Br. 33). The setting of the allowables was not appealed (J.S. App. 26a); it thus cannot form the basis for a discrimination claim.

Third, the KCC order is plainly not discriminatory on its face, for it applies equally to producers selling gas in the intrastate and interstate markets. Nor is the KCC order discriminatory in its effect. The failure of any producer to produce the gas allowable for any well in the Hugoton Field will result in cancellation of underages in a known and equal manner.[15]

The KCC order merely encourages all Kansas producers to exercise their production rights sooner rather than later. In fact, if producers with interstate purchasers gained increased markets, the KCC order would

[14] The KCC's purpose cannot be inferred from the remarks of a non-decisional employee whose proposal the KCC did not entirely accept. More important, the opinion of a subordinate employee is not probative of the purpose of the decisionmaking body. The legislative purpose cannot even be inferred from the intent of individual legislators (*see City of Renton v. Playtime Theatres, Inc.*, 475 U.S. 41, 49 (1986); *United States v. O'Brien*, 391 U.S. 367, 383-84 (1968)), much less their employees.

[15] Even if discrimination were shown, the order would not be invalid. The Commerce Clause is violated not by discrimination in and of itself, but by discrimination that is not justified by a valid factor other than economic protectionism. *See New Energy*, 108 S. Ct. at 1807. In this case, the KCC order is justified by strong and valid local concerns; it was designed to protect the correlative rights of all gas producers in the Kansas Hugoton Field.

protect the interstate producers from suffering drainage. In *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 126 (1978), the Court recognized that some state regulatory actions have an inevitable impact on the interstate market. But "[t]he fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce" (*id.* at 126).

B. The KCC Order Does Not Unduly Burden Interstate Commerce.

In recent years, the Court has also employed a balancing test, set forth in *Pike v. Bruce Church*, 397 U.S. 137 (1970), in order to determine whether a state regulation burdens interstate commerce in violation of the Commerce Clause:

> Where [a] statute regulates evenhandedly to effectuate a legitimate local public interest and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits . . . If a legitimate local purpose is found, then the question becomes one of degree and the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

397 U.S. at 142. *See Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n*, 461 U.S. 375, 393, 394 (1983); *City of Philadelphia v. New Jersey*, 437 U.S. at 624. The KCC order plainly passes the balancing test.[16]

[16] *Amici* have previously argued that the "balancing" component of the *Pike v. Bruce Church* standard that measures whether the burden on interstate commerce imposed by a state statute "is clearly excessive in relation to the putative local benefits" is inappropriate and should be discarded. *See Brief of the National Governors' Association, et al.*, as *amici curiae* in *Transcontinental*

Appellant's argument that "the KCC's order impermissibly burdens interstate commerce by coercing pipelines to give Kansas a larger share of the interstate gas market at the expense of interests in other states" (App. Br. 31) is not notably different from its contention, discussed above, that the KCC order is discriminatory because it "force[s] interstate pipelines to take more gas from Kansas and less from other states" (App. Br. 32). A separate inquiry into burden is not appropriate in this case. The concept of burden belongs only to the context of the dormant Commerce Clause; it is the Court's formulation of that Clause's self-executing limitations on state regulation. *See Whitfield v. Ohio*, 297 U.S. 431, 437-40 (1936). Where Congress has acted, that is, in the context of the active Commerce Clause, the relevant inquiry is whether Congress has authorized the state regulation. *Compare Leisy v. Hardin*, 135 U.S. 100, 109-10 (1890), *with In re Rehrer*, 140 U.S. 545 (1891). The NGA expressly excludes from federal regulation, and therefore reserves to the States, the regulation of natural gas production. Thus, the determination that the KCC order regulates production ends the inquiry.

In any event, the KCC order is not burdensome in light of the important local purposes that it serves. The record before the KCC was replete with evidence that the Hugo-

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Gas Pipe Line Corp. v. State Oil and Gas Board, No. 84-1076, at 21-27; *Schneidewind v. ANR Pipeline Co.*, No. 86-986, at 21 n.9; and *New Energy Co. of Indiana v. Limbach*, No. 87-654 at 8 n.2. The defects inherent in the *Pike v. Bruce Church* standard have been identified by Justice Scalia in his concurring opinions in *CTS Corp. v. Dynamics Corp. of America*, 107 S.Ct. 1637, 1652-53 (1987), and *Bendix Autolite Corp. v. Midwesco Enterprises*, 108 S.Ct. 2218, 2223-24 (1988). Undertaking an analysis of the potential excessiveness of state regulation in addressing a state problem is a legislative function (akin to a determination whether the penalty fits the crime) that rightly belongs to the legislative and executive branches. Although we believe that the *Pike v. Bruce Church* standard should be reconsidered, the KCC order unquestionably satisfies it.

ton Field was out of balance because of increased levels of underages that resulted in a loss of correlative rights (J.S. App. 73a-77a). It is the responsibility of the KCC to take any reasonable action that, in its judgment, might correct this problem. Kan. Stat. Ann. § 55-703. The KCC chose a range of time periods designed to protect correlative rights and to allow the Hugoton Field to develop in an orderly fashion. Appellant's mere disagreement with the KCC order does not make it unreasonable or unconstitutional.

CONCLUSION

For the foregoing reasons, the judgment of the Supreme Court of Kansas should be affirmed.

Respectfully submitted,

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APPENDIX A

States With Natural Gas Production Laws Similar to the Kansas Law

Arizona —Ariz. Rev. Stat. Ann. §§ 27-505-506 (1976) (State is empowered to regulate "the allowable production" of gas from pools)

Colorado —Colo. Rev. Stat. § 34-60-117 (1984) (State is empowered to "allocate or distribute the allowable production" of gas among the wells or properties within a pool to prevent or minimize reasonably avoidable drainage and waste and to protect correlative rights)

Florida —Fla. Stat. Ann. § 377.30 (West 1987) (State is empowered to fix allowables for pools to prevent waste of gas and "shall prorate or distribute" the allowable production)

Iowa —Iowa Code Ann. § 84.6 (West 1984) (State shall set allowables and "limit the production" of gas to meet market demand)

Louisiana —La. Rev. Stat. Ann. § 30:4 (West 1975) (State is empowered "[t]o limit and prorate the production of . . . gas . . . from any pool or field for the prevention of waste.")

Mississippi —Miss. Code Ann. § 53-1-17 (1972 & Supp. 1987) (State is empowered "to allocate and apportion the production" of gas from a pool to ensure each producer receives a just and equitable share)

Missouri —Mo. Ann. Stat. § 259.090 (Vernon Supp. 1988) (State "shall limit the production" of gas to meet market demand and "shall allocate or distribute the allowable production" among pools)

Nebraska —Neb. Rev. Stat. § 57-907 (1984) (State "shall limit the production" of gas from each pool to prevent waste of gas; State "shall allocate or distribute the allowable production" among the several wells or production properties in a pool)

New Mexico —N.M. Stat. Ann. § 70-2-17 (1987) (State is empowered to limit gas production, set allowables, and to "establish a proration unit for each pool")

North Carolina—N.C. Gen. Stat. § 113-394 (1987) (State "shall prorate or distribute the 'allowable' production" of gas among producers in a pool)

North Dakota —N.D. Cent. Code § 38-08.04 (1987) (State is empowered to "limit and to allocate" gas production from any field, pool, or marketing district)

Oklahoma —Okla. Stat. Ann. tit. 52, § 86.3 (West 1969) (State is empowered to "limit the production of gas" from any field, pool, or area to a percentage of the capacity of wells to produce)

Oregon —Ore. Rev. Stat. § 520.210 (1981) (State may limit production of gas from a pool to prevent waste and to protect correlative rights)

South Dakota —S.D. Codified Laws Ann. § 45-9-24 (1983) (State may limit "allowable production" of gas from wells to prevent waste and to protect correlative rights)

Texas —Texas Nat. Res. Code Ann. §§ 86.081-86.083 (Vernon 1978 and Supp. 1988) (State shall "prorate, allocate, and regulate" gas production to prevent waste and to adjust correlative rights)

Washington —Wash. Rev. Code Ann. § 78.52.180 (1962) (State "has authority to limit and to prorate" gas production and to compensate for any production in excess of allowable)

Wyoming —Wyo. Stat. § 30-5-102 (1977) (State "shall allocate or distribute the allowable production of gas among the several wells or producing properties in the pool" to prevent or minimize reasonably avoidable drainage and waste)

AMICUS CURIAE

BRIEF

(11)

Supreme Court, U.S.
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No. 86-1856

In the Supreme Court of the United States

OCTOBER TERM, 1988

NORTHWEST CENTRAL PIPELINE CORPORATION, APPELLANT

v.

STATE CORPORATION COMMISSION OF KANSAS, ET AL.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

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QUESTION PRESENTED

Whether an order of the Kansas Corporation Commission, placing time limits on the period during which non-producing natural gas wells in the Kansas Hugoton field can accumulate production credits without having them permanently cancelled (1) impermissibly interferes with the federal regulatory scheme established under the Natural Gas Act, 15 U.S.C. 717 *et seq.*, and the Natural Gas Policy Act of 1978, 15 U.S.C. 3301 *et seq.*, or (2) exceeds the State's power under the Commerce Clause of the United States Constitution.

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BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

INTEREST OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

The central issue presented by this appeal is whether respondent's regulation of the production of gas in the Hugoton field is preempted by the Federal Energy Regulatory Commission's[1] regulatory authority, or whether it legitimately falls within the "production or gathering" exemption contained in Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b). Resolution of that issue is of evident importance to the Commission in carrying out its regulatory responsibilities. The Court invited the Solicitor General to express the views of the United States at earlier stages of this case.

[1] We will use the term "Commission" throughout this brief to refer to the Federal Power Commission for periods before October 1, 1979, and to the Federal Energy Regulatory Commission for periods thereafter.

STATEMENT

This case arises out of a fundamental disagreement over the timing of production from the large supplies of relatively low priced natural gas in the Hugoton Reservoir. Kansas seeks to encourage current production of the Hugoton gas, and issued the challenged order with that goal in mind. Appellants, on the other hand, wish to reserve that gas for future sales; they claim that the State's effort to encourage production is inconsistent with the federal scheme of regulation.

A. The Federal Statutory and Regulatory Background

1. The Natural Gas Act, 15 U.S.C. 717 *et seq.* (NGA), reflects a segmented system of regulation, consisting of production and gathering at one end, interstate transportation and sale in interstate commerce for resale in the middle, and local distribution at the other end. See 15 U.S.C. 717(b). The Act gives the Commission comprehensive regulatory authority over the "middle segment, with production on one end and distribution on the other committed to the control of different states." *FPC* v. *East Ohio Gas Co.*, 338 U.S. 464, 488 (1950) (Jackson, J. dissenting).

Within the "middle segment", the Commission regulates market entry through its authority under Section 7(e) of the NGA, 15 U.S.C. 717f(e), to issue certificates of public convenience and necessity authorizing natural gas companies to transport or sell gas in interstate commerce; it regulates market exit through its authority to grant permission to abandon certificated service (15 U.S.C. 717f(b)). In addition, under Sections 4 and 5 of the NGA, 15 U.S.C. 717c and 717d, the Commission regulates the price and other terms of sales for resale and of transportation, ensuring that the rates and charges for such services, as well as all rules, regulations, practices, and

contracts affecting those rates and charges, are just and reasonable (see 15 U.S.C. 717c(a)).

In 1978 Congress adopted the Natural Gas Policy Act, 15 U.S.C. 3301 *et seq.* (NGPA), "to give market forces a more significant role in determining the supply, the demand, and the price of natural gas." *Transcontinental Pipe Line Corp.* v. *State Oil & Gas Board,* 474 U.S. 409, 422 (1986) (*Transco*). The NGPA set new, higher price ceilings for "new" or hard to produce gas as an incentive to production, and eliminated the Commission's jurisdiction, over time, over the wellhead price of that "new" gas. However, "old" gas like that in the Hugoton field—*i.e.*, gas already "committed or dedicated to interstate commerce" when the NGPA was enacted and not otherwise excluded from federal regulation pursuant to Section 601(a)(1)(B) of the NGPA, 15 U.S.C. 3431(a)(1)(B)—remains subject to the price ceilings established under the NGA, as well as the abandonment requirements of Section 7.

2. Prior to the enactment of the NGPA, the interstate gas market was plagued by widespread shortages. Many interstate pipelines reacted to those shortages, as well as to new opportunities to purchase gas made available under the NGPA, by contracting to purchase relatively large quantities of gas for their customers at relatively high prices, under contracts with so called "take-or-pay" clauses. However, partly in response to new supply incentives created by the NGPA, and in part because of reduced demand caused by increased prices and other factors, the shortages of gas in the 1970's turned into a surplus by the early 1980's. When the over-supply developed, many pipelines with heavy commitments to take-or-pay contracts reacted by reducing or stopping altogether their purchases under contracts offering low cost supplies that did not require them to take any particular quantity of gas, and instead fulfilled their customers' reduced demand for

gas from the more costly sources which obligated them to take-or-pay.[2]

The Commission has taken several steps to deal with the distortions in the market resulting from these actions. In essence the Commission's programs have attempted to "free up" gas by opening up access to the pipelines' systems. Under these programs, the pipeline's role has been largely changed from that of a merchant—buying gas at the wellhead and transporting it for resale to local distribution companies—to that of a transporter of "third party" gas from seller to buyer (Commission Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol).[3] The effect is to permit local distribution companies to buy directly from producers at the wellhead.[4] The Commission' regulatory policy thus

[2] See *Kansas Power & Light Co.* v. *FERC*, No. 87-1366 (D.C. Cir. July 19, 1988), slip op. 6; *Consolidated Edison Co.* v. *FERC*, 823 F.2d 630, 634 (D.C. Cir. 1987); Pierce, *Reconstituting the Natural Gas Industry From Wellhead to Burnertip*, 9 Energy L.J. 1, 12 (1988).

[3] Reprinted at F.E.R.C. Stats. & Regs. ¶ 30,665 (1985), rev'd and remanded, *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), cert. denied, *sub nom. Southern California Gas Co.* v. *FERC*, No. 87-1091 (Apr. 18, 1988); see also Order No. 500, 52 Fed. Reg. 30334 (1987) (readopting Order No. 436 regulations, with modifications, in response to that decision), petitions for review pending *sub nom. American Gas Ass'n, et al.* v. *FERC*, Nos. 87-1588 *et al.* (D.C. Cir.).

[4] The Commission has also changed the abandonment rules of Section 7 of the NGA to enable producers more readily to sell gas on the interstate market that would otherwise be obligated to certificated pipelines that did not wish to buy it. See *Kansas Power & Light*, slip op. 7; Order No. 490, Abandonment of Sales and Purchases for Natural Gas under Expired, Terminated, or Modified Contracts, 42 Fed. Energy Reg. Comm'n Rep (CCH) ¶ 61,173 (1988), reh'g denied, Order No. 480A, 44 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,133 (1988), petitions for review pending *sub nom. Marathon Oil Co.* v. *FERC*, No. 88-3666 (6th Cir. July 26, 1988).

In addition, the Commission has adopted a program that permits producers to negotiate new prices for old gas. If the certificated

seeks to make gas more readily available to consumers from a variety of sources, allowing the market for natural gas to develop in a competitive fashion. It is thereby exercising its federal role "to 'overse[e] a national market price regulatory scheme.' " *Transco*, 474 U.S. at 421, citation omitted.

B. The Kansas Commission Rule At Issue Here

1. Kansas, like other gas producing states[5] has laws "to prevent the inequitable or unfair taking of natural gas" (Kan. Stat. Ann. § 55-703 (1983); J.S. App. 111a-112a), and to prevent "economic waste, underground waste and surface waste" in its production (Kan. Stat. Ann. §§ 55-701, 55-702 (1983); J.S. App. 110a-111a). The State regulates on a field-by-field basis, with the Hugoton field, because of its enormous size and special problems, receiving particular attention.[6]

pipeline cannot reach agreement on a new price with the producer, the producer may abandon the "dedicated" sale of gas if it has contracted to sell the gas to a new purchaser. Order No. 451, *reprinted at* F.E.R.C. Stats. & Regs. ¶ 30,701 (1986); Order No. 451-A, Order Granting Rehearing In Part, Denying Rehearing In Part, and Clarifying Final Rule, F.E.R.C. Stats. & Regs. ¶ 30,720 (1986); Order No. 451-B, Order Granting Rehearing In Part, Denying Rehearing In Part, Clarifying Final Rule, And Denying Stay Request, F.E.R.C. Stat. & Reg. ¶ 30,748 (1987) and Order No. 451-C, Order Denying Rehearing, 40 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,167 (1987), petitions for review pending *sub nom. Mobil Oil Exploration & Producing Southeast, Inc.* v. *FERC*, Nos. 86-4940, *et al.* (5th Cir.).

[5] See generally *Symposium: Workshop on Natural Gas Prorationing and Ratable Takes Regulation*, 57 U. Colo. L. Rev. 149 (1986).

[6] Lungren, *Natural Gas Prorationing in Kansas*, 57 U. Colo. L. Rev. 251 (1986). The Hugoton field extends across portions of Kansas, Oklahoma and Texas, with about two thirds of its acreage (about 1000 square miles) underlying Kansas. There are thousands of wells, many with multiple owners, in the field (J.S. App. 17a). At one

Since 1944 the Kansas Corporation Commission (KCC) has regulated the production of gas in the Hugoton field so that each well may "produce ultimately at least approximately the amount of gas underlying the lease on which such well is located." Basic Proration Order for the Hugoton Gas Field 12-13 (J.A. 10). This is done by fixing maximum monthly gas production rates—called "allowables"—for all wells in the field. The KCC first sets a monthly gas production ceiling (pegged to an estimate of market demand) for the field as a whole.[7] It then assigns to the various producers and their wells maximum gas production rates designed to spread the estimated market demand over all producing wells in proportion to their individual production capabilities.

In practice, however, the wells cannot be operated to meet their monthly allowables precisely. A producing well may at times be "shut-in"—*i.e.* closed temporarily—for repair or to build up reserve pressure, or it may not have a willing buyer for its production; at other times, it may have a buyer who is willing and able to take more than the allowable. To account for under- or overproduction, the Kansas scheme incorporates a system of tolerances. If a well produces less than its allowable level, it accrues an "underage"; an overproducing well accrues an "overage." [8] Overages are offset against accrued underages if there is a purchaser for the extra gas and the well

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time, it was the largest source of gas production in the United States, if not the world (*id.* at 55a). It has remaining recoverable reserves of approximately nine trillion cubic feet (J.A. 87).

[7] The market demand levels are determined twice a year after public hearings. The KCC solicits from pipelines and producers estimates of upcoming gas production needs. While not bound by these estimates, the KCC uses them as supporting evidence for its analysis.

[8] A well may, however, produce up to six times its allowable in any one month without accruing an overage (J.S. App. 124a).

can physically produce it (J.S. App. 17a-20a). Before the change that is challenged here, accrued underages were cancelled after they reached six times the allowable, but were reinstated under liberal rules that in effect permitted underages to be used at any time.

The purpose of the Kansas regulatory scheme is to "balance[ ] various factors in an effort to regulate production so that the amount produced over time from any well is equal to the amount of gas originally in the developed lease" (J.S. App. 17a). The formula, with allowables, underages and overages, relies on the concept of "compensating drainage" so that, while wells may produce different amounts and produce at various times, they are "in balance in the long pull" (*id.* at 18a).

Hugoton gas is low-priced old gas under the NGPA. Most of the contracts for its gas were entered into in the 1920s, 1940s, and 1950s, when pipelines had considerable market power relative to producers;[9] the contracts generally provide for low prices and impose no take-or-pay obligation on the pipeline. Principally for that reason, as well as Kansas's relatively liberal policy permitting reinstatement of underages, interstate pipelines, including appellant, have in recent years been using the field for storage, and have been filling their immediate needs elsewhere.[10] Accordingly, over time, underages for producers

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[9] See, *e.g.*, Pierce, *State Regulation of Natural Gas in a Federally Deregulated Market: The Tragedy of the Commons Revisited*, 73 Cornell L. Rev. 15, 18 (1987).

[10] See *Northwest Central Pipeline Corp.*, 44 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,222 (1988), a proceeding in which FERC staff challenged the prudence of appellant's purchasing patterns during 1984 under Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. 717c, 717d, charging that appellant overpaid for its gas because it did not purchase sufficient low cost Hugoton gas to be able to provide service at the lowest reasonable cost (slip op. 8). In affirming the deci-

serving interstate pipelines have accumulated, and by 1982 a huge amount of underages had built up, some of it dating "back at least to the 1960's" (J.S. App. 76a).[11]

2. The volume of underproduction in the Hugoton field led to tensions between producing and nonproducing interests,[12] and ultimately to a KCC investigation (J.S. App. 20a, 65a). As a result of this investigation, the KCC concluded (*id.* at 76a) that:

> [I]t is in the public interest and in the interest of the producers to clear up this underage dilemma as much as possible. In the future, it will be practically impossible to ascertain the balance of the field if underages relate backward in perpetuity. Some sort of benchmark is necessary if the Commission is to effectively balance takes from the field. Given the current high volume of cancelled underage, the Commission finds that it is doubtful that much of the underage cancelled prior to 1975 will be able to be produced.

Accordingly, the KCC changed the underage rules. Under an amendment to the Basic Proration Order adopted in

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sion of its Administrative Law Judge, the Commission found that appellant's purchases were a prudent exercise of managerial discretion.

[11] Underages reached a total of over 204 billion cubic feet of gas by 1982 (J.S. App. 74a); the total natural gas production for all of Kansas that year was a little over 430 billion cubic feet (American Gas Association, *Gas Facts: 1984 Data* 28, 29 (1985)).

[12] Natural gas within a field can migrate underground from underproduced areas to producing areas; it is thus theoretically possible to extract from a single well or group of wells an indefinitely high percentage of the recoverable natural gas in the field, exhausting not only the producing wells but also nonproducing or underproducing wells (J.S. App. 17a-18a). This phenomenon creates problems not only of equity between owners but of waste induced by a race to capture gas ahead of other wells in the same field. *Champlin Refining Co.* v. *Corporation Comm'n*, 286 U.S. 210, 228 (1932).

February 1983, underages are permanently cancelled if not reinstated and produced within specified periods of years (J.S. App. 20a-21a). The KCC explained that the prior rule "[did] not provide operators sufficient incentive to produce gas" (*id.* at 74a) and that one purpose of the change was "to encourage [production of gas]" (*id.* at 73a).

3. Together with other interstate pipelines, appellant opposed the rule change in the rulemaking proceeding before the KCC. Relying on this Court's decision in *Northern Natural Gas Co.* v. *State Corporation Comm'n*, 372 U.S. 84 (1963) (*Northern Natural*), appellant argued that the threat to cancel underages if they were not used within a specified period of years would force it to purchase more Kansas gas at a time when it did not need the gas (or else risk permanently losing gas from a well whose production was contractually committed to it), and therefore that the state was in effect directing interstate pipeline purchasing practices, a matter exclusively within the concern of FERC under the NGA. The KCC rejected this argument, emphasizing that the rule change was "directed to and affects only those who drill for and produce gas from the Hugoton Field. * * * [It] does not require pipeline[ ] purchasers to do anything or refrain from doing anything" (J.S. App. 87a).

C. The Decisions Of The State Courts

On judicial review, a Kansas district court upheld the rule change (J.S. App. 53a-60a) on the ground that it involved the "production or gathering" of gas, activities specifically excluded from the reach of federal regulation by Section 1(b) of the NGA, 15 U.S.C. 717(b).

A divided Kansas Supreme Court affirmed (J.S. App. 13a-44a). While recognizing that the new rule was an "in-

direct effort to influence purchasers" and acknowledging that "purchasers are indirectly caught in the backwash," the court upheld the rule against the challenge based on *Northern Natural* because the "rules on underages are a part of production regulation" over which the State has exclusive jurisdiction (J.S. App. 40a-41a). Chief Judge Schroeder in dissent took the view that the rule is invalid, either because the KCC had exceeded its "statutory authority in fixing allowables far in excess of demand" (J.S. App. 45a) or, alternatively, because the state regulation violated *Northern Natural*. While "directed at producers not purchasers, its real purpose is to create an impact on purchasers' business decisions concerning the makeup of their interstate gas mix" and therefore its effect is to impair the regulatory authority of FERC under the NGA (*id.* at 46a).

Appellant appealed that decision to this Court. On February 24, 1986, after deciding *Transco*, the Court vacated the Kansas Supreme Court judgment and remanded the matter for further consideration in light of that case. 475 U.S. 1002 (1986).

On remand, the Kansas Supreme Court reaffirmed its earlier decision (J.S. App. 1a-12a). In doing so, the court read *Transco* to require a determination whether the state's order "falls within the limits of a comprehensive federal regulatory scheme rather than within the category of regulatory questions reserved for the states; and, if so, whether the effect of the order will be to impair market forces" (*id.* at 8a-9a). Although finding that "any change in rates of production," such as that contemplated by the State's action in tightening the underage rules "has an effect on the interstate market" (*id.* at 11a), the Kansas court found this alone was not sufficient to preempt the state action. Rather, it concluded that the key test must be "whether the regulation is primarily directed at the marketing of gas rather than production thereof" (*ibid.*). On this basis, the court upheld the KCC rule change (*id.* at 11a-12a):

> Here, the [KCC] found the amendment * * * was necessary for the prevention of waste and protection of correlative rights. Though controverted, there is evidence in the record to support that finding. Further, any effect on the interstate sale of gas is merely incidental rather than the objective of the order.

The Kansas court consequently held that the order "does not transgress federal regulation of natural gas in interstate commerce" and upheld the rule change (*id.* at 12a).[13]

SUMMARY OF ARGUMENT

State regulation is preempted by federal law in two situations: either when federal law so pervasively occupies the field that it leaves no room for state regulation, or when the state regulation is otherwise inconsistent with the federal regulatory scheme, either because it conflicts with the federal provisions, or is an obstacle to the accomplishment of the legislative purposes. Neither situation exists in this case.

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[13] While this litigation has been proceeding, the KCC adopted further amendments, making it easier for producers to apply for reinstatement of underages and market their gas. First, the deadlines established in 1983 for requesting reinstatement of underages have been extended in a series of orders. The KCC has also eliminated several of its earlier prerequisties for reinstatement – *viz.*, that the producer be in an "overproduced status", and that the producer name a purchaser willing and able to take the accumulated underage (J.A. 24 & 30). Thus, under the current KCC order, a shut-in producer in applying for reinstatement of underages need only state that it has a purchaser willing to take gas. Once the application is filed, the producer has five years to produce the underage (J.S. App. 21a, 77a).

The NGA specifically reserves to the states the authority to control the production and gathering of natural gas. The Kansas order at issue here is an exercise of that reserved authority. Because it furthers legitimate state interests in controlling the production of the Hugoton field to avoid waste and protect correlative rights by producer regulation, it is distinguishable from the state orders in *Northern Natural* and *Transco* that were preempted because they involved state regulation of interstate pipelines, and thus invaded the field comprehensively regulated by the NGA and the NGPA.

Nor is there any inconsistency between the new Kansas system for the cancellation of underages and the federal regulatory scheme. Although the state rule change is intended to influence the purchasing decisions of the federally regulated pipelines, that intended effect is insufficient to render it inconsistent with the federal regulatory scheme. Nothing in the applicable federal regulations protects the pipelines from having to take state production and gathering regulations into consideration as part of the marketplace environment in which they make their purchasing choices. Indeed, to the extent that the Kansas rule change encourages the production and use of the low-priced old Hugoton gas, rather than the more expensive new gas, the change is entirely consistent with federal gas policy.

The Kansas order does not conflict with the Commission's authority to control the abandonment of certificated interstate service. It does not excuse any producer who wishes to obtain alternative purchasers and thereby avoid cancellation of its underages from the requirement that FERC authorize the abandonment. Nor does either Kansas or federal law give the owners of a well that takes from a common pool any vested right to a specific fixed share of the pool. A pipeline simply has no federally enforceable

right to require that gas be produced or reserved for its future purchase. Thus, it has no right that can be abandoned.

There is no violation of the Commerce Clause since the Kansas rule change is a valid exercise of its production and gathering authority, applicable alike to producers for intrastate and interstate purchasers. The amended rule is a legitimate attempt to protect state mineral resources from waste and to adjust the correlative rights of all owners of the common pool of gas. Any interstate effects of this regulatory action are simply incidental to those legitimate purposes.

ARGUMENT

I. FEDERAL LAW DOES NOT OCCUPY THE FIELD OF NATURAL GAS REGULATION TO AN EXTENT THAT PREEMPTS THE KANSAS RULE CHANGE

This Court recently summarized the circumstances in which federal law preempts state regulation in *Schneidewind* v. *ANR Pipeline Co.*, No. 86-986 (Mar. 22, 1988), slip op. 6 (citations omitted):

> Congress explicitly may define the extent to which its enactments pre-empt state law. In the absence of explicit statutory language, however, Congress implicitly may indicate an intent to occupy a given field to the exclusion of state law. Such a purpose properly may be inferred where the pervasiveness of the federal regulation precludes supplementation by the States, where the federal interest in the field is sufficiently dominant, or where "the object sought to be obtained by the federal law and the character of obligations imposed by it . . . reveal the same purpose." Finally, even where Congress has not entirely displaced state regulation in a particular field, state law is pre-

> empted when it actually conflicts with federal law. Such a conflict will be found " 'when it is impossible to comply with both state and federal law, or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress' ".

This case does not involve a situation in which Congress, either explicitly or implicitly, has occupied the field in which the State attempts to regulate. To the contrary, in enacting the NGA Congress specifically reserved to the states the regulation of "local distribution of natural gas or * * * the facilities used for such distribution" and "the production or gathering of natural gas." 15 U.S.C. 717(b). Thus, Congress in the NGA established a regulatory system for the natural gas industry in which state and federal regulatory authority necessarily must co-exist. As Justice Jackson succinctly explained in his dissenting opinion in *FPC* v. *East Ohio Gas Co.*, 338 U.S. 464, 488 (1950):

> "the Federal Commission controls only a middle segment, with production on one end and distribution on the other committed to the control of different states. But that was as far as Congress was willing to supersede state authority. It left the peculiar problems affecting production to the producing states, it left the ultimate protection of consumers to the consuming states, and it left the Federal Power Commission in the middle to fix the rates for gas moving between the two. This obviously subdivides regulation of what has to operate as a unitary enterprise, but that is often the consequence of our federal system.

As Justice Jackson's statement implies, the existence of dual regulatory authority over a unitary operation necessarily involves some tension between the two regulatory systems,[14] and the activities of one authority will necessarily affect the situation in which the other must act.[15] Nevertheless, it is clear that under the NGA and the NGPA, the states retain the general authority to control the production or gathering of natural gas. See *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 509-512 (1949) (legislative history of NGA "replete with evidence of the care taken by Congress to keep the power over production and gathering of gas within the states"); *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954). The states retain that authority, even though its exercise may have "some indirect effect on rates and facilities" of the interstate pipelines, which are subject to comprehensive federal regulatory controls (*Schneidewind*, slip op. 15).

While the production and gathering activities which the states may control are "narrowly confined to the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution" (*Northern Natural*, 372 U.S. at 90), there can be no dispute that that authority includes the power to regulate the rights of well owners to produce the gas from a common field. See, *e.g.*, *Thompson* v. *Consolidated Gas Utilities Corp.*, 300 U.S. 55, 69-70 (1937); *Champlin Refining Co.* v. *Corporation*

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[14] This sort of Congressional tolerance for dual federal/state schemes is not unique to the regulation of natural gas. Cf. *Silkwood* v. *Kerr-McGee Corp.*, 464 U.S. 238, 256 (1984) (nuclear power regulation); *Goodyear Atomic Corp.* v. *Esto Miller*, No. 86-1172 (May 23, 1988), slip op. 11 (same); *Louisiana Public Service Commission* v. *FCC*, 476 U.S. 355, 375 (1986) (telephone service regulation).

[15] As Justice Harlan pointed out in his dissent in *Northern Natural*, 372 U.S. at 100, "[t]he production of natural gas and its movement into interstate channels constitute one and the same physical operation." Accordingly, there can in practice be no bright line distinction between production and interstate movement of gas.

Comm'n, 286 U.S. 210 (1932); see also *Northern Natural,* 372 U.S. at 94-95 & n.12.

Because natural gas is a fungible commodity that migrates underground and cannot economically be stored above ground, its conservation and allocation between owners of wells taking from a common pool is "as thorny a problem as has challenged the ingenuity and wisdom of legislature" (*Railroad Comm'n* v. *Rowan & Nichols Oil Co.,* 310 U.S. 573, 579 (1940)). Various theoretically possible approaches to this problem range from the "rule of capture", under which gas belongs to whichever well owner extracts it, to a system of permanently fixed allowables, which would allocate to each well owner a specified amount of gas to be taken from the pool, over as long a period as he wishes. As a practical matter, neither of these extreme approaches is feasible; the rule of capture spurs each owner to take gas as quickly as possible (as long as the price covers the cost of extraction), thus encouraging waste and uneconomic depletion of the field (see generally 1 W.L. Summers, *The Law of Oil and Gas* §§ 61-63 (perm. ed. 1954); Hardwicke, *The Rule Of Capture and Its Implications as Applied to Oil and Gas* 13 Tex. L. Rev. 391 (1935)), while a system of fixed allowables ignores the effects of drainage and the inherent uncertainties in determining at the outset the quantity of recoverable gas underground. Accordingly, Kansas, like other states, has attempted to prevent waste and protect correlative rights by implementing a system of allowables that regulates how much gas may be withdrawn by each well owner over a short period of time. The Kansas scheme is by no means unique. Virtually every other gas producing state has a similar program for controlling the timing of production within a gas field. See *Pierce, supra,* 73 Cornell L. Rev. at

45 and authorities cited there.[16] The Kansas system has included a cancellation provision since 1944, and although there was a more liberal policy regarding reinstatement before the challenged rule change, the KCC found it unlikely that much of the pre-1975 cancellations could actually be produced (J.S. App. 76a). The challenged order is thus more in the nature of a minor adjustment to the existing state regulation than a major reversal in policy.[17]

This sort of mid-course correction is well within the jurisdiction of the KCC. Indeed, the determination that adjustments are needed, and the selection of the appropriate manner in which to make those adjustments, are precisely the sorts of determinations that are committed to the expertise of the KCC. Appellant's arguments that the rule change was unnecessary, and that in any event, the monthly gas production ceiling for the field should be reduced instead of cancelling the underages, are arguments that were appropriately addressed to the KCC (J.S. App. 75a). The KCC determined that, instead of permitting the indefinite banking of underages, with the resultant possibility of a sudden uncontrolled rise in production that might cause waste, the long-term conservation of the state's gas resources was best achieved by encouraging more stable pro-

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[16] This case is thus distinguishable from Michigan's regulation of securities in *Schneidewind* v. *ANR Pipeline Co., supra,* where the Court found it significant that Michigan was the only state that had attempted to apply such regulation to gas companies subject to FERC's jurisdiction (slip op. 17 n.13).

[17] Moreover, the practical effects of the change have been reduced by the subsequent liberalization of the provisions for qualifying for reinstatement (see note 13, *supra*). In light of the generous five-year period permitted for making up the underage once reinstatement has been granted, and the possibility of over production even in the absence of accrued underages (see note 8, *supra*), the effect of the rule change may be more theoretical than actual.

duction levels, albeit at somewhat higher rates than those that currently prevail. There is no need for this Court to question this exercise of the specialized expertise of the KCC, affirmed by the highest state court.[18]

Moreover, the fact that the rule change at issue not only is based on the state's authority to control production, but also regulates natural gas producers rather than pipelines, serves to distinguish this case from *Northern Natural* and *Transco*. In those cases, the challenged state orders, although rationalized on grounds of controlling production, involved state regulation of interstate pipelines, not producers, and so fell within the area in which federal regulation had preempted the field.[19]

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[18] Although appellant asserts (Br. 10) that the KCC's conservation purpose is "suspect" and its correlative rights rationale unexplained, there is no reason to conclude that the KCC's asserted basis for the rule change was pretextual. The KCC explained that permitting each well owner to accumulate underages indefinitely would cause waste and be unfair to the wells that do produce their monthly allowables. See J.S. App. 73a. The Kansas Supreme Court held that "[t]he amended order provides each producer an opportunity to reinstate its cancelled underages and thus the right to ultimately recover the gas under its leases • • •. [S]uch an opportunity is all the KCC can provide as it is impossible to force current equal production from all wells in the common source of supply." *Id.* at 26a. Although the state court noted that evidence before the KCC was "controverted," it upheld the commission (*id.* at 11a-12a).

[19] In *Northern Natural*, the Court ruled that a Kansas "ratable-take" order, requiring an interstate pipeline to purchase gas ratably from all wells connected to its pipeline system in each gas field within the state, was preempted by the NGA because "Congress has so plainly occupied the regulatory field" (372 U.S. at 93), and the order encroached on the exclusive regulatory jurisdiction conferred on the Commission by that statute. As the Court explained (*id.* at 92), the ratable-take requirement threatened the pipelines (not the local producers) with criminal penalties if they did not either reduce their takes from wells with which they had contracts, thus incurring liability to those producers, or increase their takes from other wells, and thus take more gas than they could currently use. In holding the ratable-take order preempted, the Court stressed that the state order at issue in *Northern Natural* was "unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce" (*ibid.* (emphasis in original)). The Court explicitly declined to address the lawfulness of a ratable take order directed exclusively at producers (*id.* at 90 n.8), but in noting the availability to the State of "alternative means of checking waste and disproportionate or discriminatory taking," the Court specifically identifed "proration and similar orders directed at producers" (*id.* at 94-95 & n.12).

In *Transco*, the Court was again confronted with a ratable take order "virtually identical" (474 U.S. at 411) to the one struck down in *Northern Natural*. The question in *Transco* was whether the rule of *Northern Natural* survived the enactment of the NGPA. The Court found that the NGPA had not eliminated the NGA's comprehensive federal regulatory scheme but had incorporated into that scheme a new element – a federal decision "to leave determination of supply and first-sale price to the market" (*Transco*, 474 U.S. at 422). Thus, the "field-occupation" preemption identified in *Northern Natural* still precluded the attempted state regulation of pipeline takes.

[20] Both in its initial opinion (J.S. App. 40a-41a) and after remand from this Court (*id.* at 11a), the state court adopted essentially a bright line between a state regulation addressed to gas producers and a regulation addressed to gas purchasers. Finding (*id.* at 11a-12a) that the Kansas order here was not "primarily directed at the marketing of gas [but at the] production thereof," it ruled that the state order was not barred by the federal scheme.

We do not, however, suggest that any and all state regulation of natural gas producers is free from challenge under the "production or gathering" exemption. Thus, we do not agree with the state court's conclusion that the Kansas order is necessarily lawful simply because it furthers legitimate state interests in regulating production.[20] The critical question remains whether this otherwise proper exercise of state regulatory authority interferes with the comprehensive federal scheme of interstate pipeline regulation.

II. THE KANSAS ORDER DOES NOT CONFLICT WITH, OR PRESENT AN OBSTACLE TO, THE ACCOMPLISHMENT OF THE GOALS OF FEDERAL REGULATION

Even where Congress has not entirely displaced state regulation in a particular field, state law is preempted when it actually conflicts with federal law. Such a conflict will be found " 'when it is impossible to comply with both state and federal law, or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress." *Schneidewind* v. *ANR Pipeline Co.*, slip op. 6 (citations omitted).

The possibility of this type of "conflict" preemption is particularly strong here, because the Kansas order, as the Kansas Supreme Court recognized, is "intended for purchasers [even though] directed to producers" (J.S. App. 40a). That is, it is intended to increase production from the Hugoton field, and that goal is, to some extent, dependent on the pipeline's being persuaded to take additional gas rather than risk the cancellation of its producer's underages (*id.* at 37a).[21] At bottom, however, the state's rule change, whatever its intent, involves no more than fixing limits on when producers may produce their gas.

The pipeline's decision whether to respond to the state's rule change by altering its pattern of purchases from the Hugoton field will be determined by a host of interrelated factors, including other states' production regulations,

[21] Although there was some question whether the rule as originally adopted and reviewed by the Kansas Supreme Court would induce the pipelines to make the desired changes (see J.S. App. 37a), the subsequent liberalization of the rule makes it easier for producers to avoid the cancellation of underages by obtaining alternative purchasers and qualifying for reinstatement of cancelled underages. See note 13, *supra*. Thus, the KCC rule change, as amended, is designed to encourage producers, as well as pipelines, to react in ways that will achieve the purposes of the rule change.

available reserves from alternative sources, potential take-or-pay-liability, and the pipeline's (and its Hugoton supplier's) evaluation of whether there is any threat of actual unrecoverable drainage of Hugoton reserves. The current KCC rule regarding underage cancellations is simply part of the matrix in which the pipeline's purchasing decisions must be made, just as virtually any other state regulation may affect the business decisions of interstate companies (*e.g.*, tax laws or minimum wage laws that affect a plant siting decision). Cf. *Exxon Corp.* v. *Governor of Maryland*, 437 U.S. 117, 126 (1978). The pipeline may not rely on the fact that it is subject to comprehensive federal regulation to protect itself from the effects of state regulations that form the environment in which it conducts its business within the state.[22] Appellant offers no evidence of a congressional intent to intrude on traditional, otherwise valid state regulation of production merely because it may affect a pipeline's choice among purchasing alternatives, all of which are permitted by its contracts and the federal regulatory scheme. See 124 Cong. Rec. 38366 (1978) (remarks of Rep. Dingell, House Manager of the NGPA, explaining that state authority to prorate production is unaffected by NGPA).[23]

[22] The contrary rule urged by appellants would, in practice, free interstate pipeline purchase decisions from all regulatory controls. If the state cannot impose field production controls that may affect interstate pipeline purchasing decisions, and FERC cannot control gas production and gathering, field production would be determined in large measure by the unregulated purchase decisions of interstate pipelines.

[23] Appellant's argument that the rationale of *Transco* and *Northern Natural* requires that all state actions imposing economic consequences on pipeline purchasing choices be preempted ignores the difference betwen the "field-occupation" type of preemption at issue in those cases, and the "conflict or obstacle" type at issue here.

To be sure, the KCC order may induce a pipeline to take more Hugoton gas. FERC, in reviewing the prudence of that decision, will be required to recognize the existence of the Kansas order as a factor affecting the pipeline's purchasing choice. See 44 Fed. Energy Reg. Comm'n Rep. (CCH) at ¶ 61,222.[24] FERC's "prudence" determinations are based on a case-by-case evaluation of what a reasonable utility management would have done in the same circumstances at the time the purchase decision was made. In no way does the KCC underage cancellation provision dictate the outcome of such an evaluation, or limit FERC's authority to consider these matters.[25]

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[24] Similarly, at the other end of the federal regulatory "middle segment" (see page 14, *supra*), there is an "inevitable overlap" between FERC's authority to set just and reasonable wholesale rates for natural gas under § 4(a) of the NGA (15 U.S.C. 717c(a))) and the state's authority over retail rates under the specific exclusion of Section 717(b). *Kentucky West Virginia Gas Co.* v. *Pennsylvania Pub. Utility Comm'n*, 837 F.2d 600, 615 (3d Cir. 1988). But a state may impose a "least cost" purchasing requirement on local utilities' purchases of wholesale gas from federally regulated pipelines without conflicting with FERC's jurisdiction to set wholesale rates, and the state may then evaluate the prudence of the utility's choice among the variety of FERC-established wholesale rates available to it in the market. *Kentucky West Virginia Gas Co.* v. *Pennsylvania Pub. Utility Comm'n, supra; Pike County Light and Power* v. *Pennsylvania Pub. Utility Comm'n*, 465 A.2d 735 (Pa. Comm. Ct. 1983); *Narragansett Electric Co.* v. *FERC*, 381 A.2d 1358 (R.I. 1977), cert. denied, 435 U.S. 972 (1978). Indeed, without deciding the matter, this Court has assumed that the exercise of such state authority is proper. See *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986) (ruling that a state attempt to exercise its authority over retail rates to deny a passthrough of specific FERC-approved wholesale rates, or FERC-determined allocations of wholesale power at a particular price level, is preempted).

[25] Unlike the Mississippi order in *Transco*, which *required* the pipeline to alter its contractual arrangements, and thus in effect foreclosed federal oversight of purchasing practices (474 U.S. at 424 n.5), the Kansas rule change imposes no such direct obligation. The possibility of a loss of underages by the pipeline's supplier is a factor in the pipeline's purchasing decision, and in FERC's review of the prudence of that decision. But consideration of that factor no more intrudes on FERC's jurisdiction over pipeline purchasing decisions than does consideration of other factors affecting the market in which the pipeline operates.

In any event, the state rule change at issue here furthers, rather than stands as an obstacle to, the achievement of federal regulatory goals. Because the most likely economic impact of the challenged regulation (particularly as amended) is to spur more production of relatively low cost Hugoton gas into interstate commerce in the near term—a goal FERC itself is pursuing through various federal initiatives (see pages 4-5, *supra*,)—the Kansas regulation appears to be perfectly congruent with the overall federal interest.[26]

Finally, appellant asserts (Br. 24-28) that the state rule change is preempted because it conflicts with FERC's authority to determine whether natural gas companies may abandon certificated interstate service. Appellant correctly notes that FERC's abandonment authority under Section 7 of the NGA applies to Hugoton gas contracts that have been certificated by the Commission.[27]

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[26] If appellant and other interstate pipelines that are using the Hugoton field for storage are encouraged by the Kansas order to begin taking more low priced Hugoton gas from the shut-in producers, "the resulting increased supply of old gas will displace higher-cost gas, create more competition in the market place, and thus bring down overall prices", achieving the goal enunciated in Order No. 451, *supra*, at FERC Stats & Regs ¶ 30,701 at 30,252. This overall federal policy will be equally served if shut-in Hugoton producers respond to the Kansas order by seeking out new interstate purchasers for their gas under FERC's liberalized abandonment policy and Order No. 451.

[27] Although the NGPA eliminated the Commission's abandonment authority with respect to certain categories of "new gas," it did not

Therefore, any shut-in Kansas Hugoton producer who might respond to the threatened cancellation of underages by diverting his production to a purchaser other than the certificated purchaser, must obtain FERC abandonment authority. But nothing in the Kansas rule change can be read as even remotely interfering with seeking—or obtaining—such authorization. There is here no situation like the one noted in *Florida Lime & Avocado Growers, Inc.* v. *Paul,* 373 U.S. 132, 142-143 (1963), where compliance with both state and federal law is impossible. It is clearly possible for a producer to obtain FERC abandonment authorization, and thus to avoid the cancellation of underages by finding an alternative purchaser for gas the certificated pipeline is unwilling to take. Indeed, the new FERC abandonment policy, including provisions for limited term abandonments and for expedited grants of abandonment authority under Order No. 451 in situations where the presently certificated pipeline declines to renegotiate its contract with the producer (see note 4, *supra*), dovetails with the Kansas order by providing an avenue of relief to shut-in suppliers facing cancellation of underages.

To the extent that appellant further contends that the state's cancellation of underages itself affects an unauthorized abandonment, the contention misperceives both state and federal law. A state use-it-or-lose-it requirement, such as is involved here, would be in conflict with FERC abandonment authority only if the well owner had a vested right to a fixed quantity of gas in the pool, which he could take from the pool over as long a period as he wished.

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relieve producers of their legal duty to sell their "dedicated" gas to the interstate market; moreover, the Act specifically provides that gas flowing in interstate commerce before the NGPA was enacted generally remains under the Commission's NGA authority (15 U.S.C. 3431(a)).

Neither Kansas nor any other state has such a system of permanently fixed allowables, however, and no such right can be implied from the federal regulatory control over abandonments. Federal law simply does not extend to unproduced gas. FERC's abandonment authority extends to insuring that gas that *is* produced from committed or dedicated leases and wells moves into interstate commerce (see, *e.g., United Gas Pipe Line Co.* v. *McCombs,* 442 U.S. 529 (1979)). But the Commission has no authority to *compel* gas production. *Shell Oil Co.* v. *FERC,* 566 F.2d 536 (5th Cir. 1978) (rejecting a FERC claim of authority to impose a "prudent operator" standard on certificated producers), aff'd by an equally divided Court, 440 U.S. 192 (1979).[28] A pipeline therefore has no federally enforceable right to require that gas be produced or that it be protected for future purchase, and Kansas is under no federal obligation to adopt a fixed-entitlement system of allowables.

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[28] See *Panhandle Eastern Pipeline Co.* v. *TXO Production Corp.,* 34 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,292 (1986), reh'g denied, 36 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,182 (1986). There, an interstate pipeline alleged that two producers had unlawfully diverted gas reserves dedicated to the interstate market without abandonment authority under Section 7(b) by draining gas from under the pipeline's dedicated lease. FERC held that although it unquestionably had jurisdiction to determine whether abandonment had occurred, in fact there had been no violation of federal law. The question of the propriety of the challenged activities was properly resolved by the state under its "production and gathering" jurisdiction (34 Fed. Energy Reg. Comm'n Rep. (CCH) at 61,525). In denying rehearing, the Commission explained that the pipeline's abandonment theory was based on the misconception that the migrating gas was "dedicated" (*id.* at 61,469):

> [W]here a common reservior underlies both dedicated and non-dedicated leases, the gas therein cannot properly be characterized as dedicated or not dedicated until it actually is produced at the wellhead.

Appellant's suggestion (Br. 26-28) that the migration of gas from less active producers with interstate contracts to overproducing wells supplying the intra-state market constitutes unauthorized abandonment is flawed for another, independent reason. The physical phenomenon of migration is precisely the problem the Kansas order is designed to correct by encouraging production by currently shut-in wells. If the Kansas order is struck down, presumably whatever loss of reserves is occurring due to uncompensated drainage will continue. With or without the challenged order, the solution to the potential drainage of such reserves is within the control of pipelines, which may begin to purchase gas at any time. This drainage cannot therefore fairly be attributed to the Kansas order.

III. THE COMMERCE CLAUSE IS NOT VIOLATED

Appellant's Commerce Clause argument is without merit. The argument is premised on the contention that the KCC order is "simple economic protectionism" that discriminates against out-of-state purchasers. In fact, the challenged order is neutral; it operates to cancel the underages of any non-producing well, not just those with interstate purchasers. Cf. *Exxon Corp.* v. *Governor of Maryland,* 437 U.S. at 126. In any case, we have shown that the Kansas order is a legitimate attempt to conserve state resources and protect ownership rights in the Hugoton field; it is therefore a proper regulation of production under the power reserved to the states by Section 1(b) of the NGA. Since the order has only a permissible incidental effect on interstate commerce (see pages 20-21, *supra*), the Commerce Clause challenge necessarily fails. See *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970); *Champlin Refining Co.* v. *Corporation Comm'n,* 286 U.S. 210, 235 (1932); *Arkansas Electric Cooperative Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983).

CONCLUSION

The judgment of the Kansas Supreme Court should be affirmed.

Respectfully submitted.

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AMICUS CURIAE

BRIEF

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JOSEPH F. SPANIOL, JR.

NO. 86-1856

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1988

NORTHWEST CENTRAL PIPELINE CORPORATION
Appellant
v.
STATE CORPORATION COMMISSION
OF KANSAS, *ET AL.*
Appellee

ON APPEAL FROM THE SUPREME COURT OF KANSAS

BRIEF FOR THE RAILROAD COMMISSION OF TEXAS, LOUISIANA OFFICE OF CONSERVATION OF THE DEPARTMENT OF NATURAL RESOURCES, NEW MEXICO ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT, NORTH DAKOTA INDUSTRIAL COMMISSION, AND OKLAHOMA CORPORATION COMMISSION AS *AMICI CURIAE* IN SUPPORT OF THE STATE CORPORATION COMMISSION OF KANSAS, *ET AL.*

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QUESTION PRESENTED

Whether an order of the Kansas Corporation Commission regulating the amount of gas that may be produced from Kansas gas wells is preempted by the Natural Gas Act, 15 U.S.C. §717 *et seq.*, and the Natural Gas Policy Act of 1978, 15 U.S.C. §3301 *et seq.*, or exceeds the State's power under the Commerce Clause of the United States Constitution.

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NO. 86-1856

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1988

NORTHWEST CENTRAL PIPELINE CORPORATION,
Appellant

v.

STATE CORPORATION COMMISSION OF KANSAS, *ET AL.*
Appellee

ON APPEAL FROM
THE SUPREME COURT OF KANSAS

BRIEF FOR THE RAILROAD COMMISSION OF TEXAS, LOUISIANA OFFICE OF CONSERVATION OF THE DEPARTMENT OF NATURAL RESOURCES, NEW MEXICO ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT, NORTH DAKOTA INDUSTRIAL COMMISSION, AND OKLAHOMA CORPORATION COMMISSION AS *AMICI CURIAE*

I. Interest of *Amici Curiae*.

The above-listed oil and gas regulatory agencies of Texas, Louisiana, New Mexico, North Dakota and Oklahoma file this brief as *amici curiae*, pursuant to letters of consent obtained from all parties to this proceeding and filed herewith. Each of these states has enacted its own regulatory scheme to establish a property rights system in common reservoirs to ensure the orderly, nonwasteful and equitable development of natural resources located within its boundaries. Tex. Nat. Res. Code Ann. §§85.055, 86.081 (Vernon 1978 and Supp. 1988); La. Rev. Stat. Ann. §30.11 (West 1975); N.M. Stat. Ann. §70-2-16 (Supp. 1986); N.D. Cent. Code §38-08-06 (1987); Okla. Stat. Ann. tit. 52 §239

(1969). These states have a vital interest in the outcome of this case and have great familiarity with the subject matter. In the aggregate, these states produce approximately 81% of the natural gas marketed from the fifty United States. *See* U.S. Department of Energy, Natural Gas Monthly at 31-33 (April, 1988); U.S. Department of Energy, 1 Natural Gas Annual 1986 at 9. These states urge the Court to affirm the decision of the Kansas Supreme Court and uphold the validity of the proration order issued by the State Corporation Commission of Kansas.

II. Statement of the Case.

The Corporation Commission of Kansas is the state agency responsible for administering Kansas laws concerning the protection of correlative rights and prevention of waste relative to natural gas. *See* Kan. Stat. Ann. §§55-701, 55-702, 55-703 (1983). In 1983, the Corporation Commission issued a gas proration order amending paragraph (P) of the Basic Proration Order for the Hugoton Field. This amendment to paragraph (P) provided that accumulated underproduction (past assigned allowables that had not been produced) ("underage") in the Hugoton Field would be cancelled permanently when underage equal to six times the monthly allowable had accumulated, if the producer did not reinstate the underage within two years, or, if reinstated, the underage was not produced within five years.

Prior to this amendment, Kansas gas producers had greater flexibility in reinstating and producing cancelled underages. Producers in the field and pipeline companies appealed this order of the Corporation Commission. The Kansas District Court affirmed the order. On appeal, the Kansas Supreme Court affirmed the District Court. Upon review, the United States Supreme Court vacated and remanded the case back to the Kansas Supreme Court for reconsideration in light of *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Bd.*, 106 S. Ct. 709 (1986) ("*Transco*"). Upon reconsideration, the Kansas Supreme Court upheld the validity of the Corporation Commission's

order. 240 Kan. 638, 732 P.2d 775 (1987). Northwest Central Pipeline Corporation has asked this Court to review this Kansas Supreme Court decision.

III. Summary of Argument.

The proration order issued by the Corporation Commission of Kansas is a valid exercise of the state's power to prevent waste and to protect correlative rights. The order clearly lies within the "production" and "gathering" exemption of the Natural Gas Act of 1938, 15 U.S.C. §717 *et seq.* ("NGA"), which left control over production and gathering activities to the states. Further, the order is not preempted under *Northern Natural Gas Co. v. State Corp. Commission*, 372 U.S. 84 (1963) ("*Northern Natural*") or *Transco*. The Court should reconsider its preemption analysis in these two prior cases. A standard that preempts state regulation having any direct or indirect price effects on natural gas is an impossible standard that the states cannot meet and still perform their essential function of promoting conservation and protecting correlative rights. However, even if the preemption analysis used in *Northern Natural* and *Transco* is held to be correct, the present case is distinguishable in that this order is directed at producers, and does not require anything of interstate purchasers.

Further, the order of the Corporation Commission does not actually conflict with federal law. Interstate purchasers can easily comply with the Kansas order and federal law. Furthermore, the Kansas order is part of a legitimate state gas proration system, and is entirely consistent with accomplishment of the full purposes and objectives of Congress. State-administered proration systems define property rights in natural gas resources and, therefore, contribute fundamentally to the efficient functioning of free markets. This Court has found a Congressional intent to give market forces a "more significant role in determining the supply, the demand, and the price of natural gas...." *Transco*, 106 S. Ct. at 717.

Last, as a conservation measure applied evenly to wells

dedicated to interstate commerce and to wells not dedicated to interstate commerce, the Kansas order does not violate the Commerce Clause of the United States Constitution. U.S. Const. Art. I §8, cl. 3.

IV. Argument.

A. State Prorationing is a Legitimate Exercise of State Power.

The order issued by the Corporation Commission of Kansas is a legitimate exercise of state power. State proration systems are necessary to ensure the equitable allocation of production opportunities among wells in a natural gas reservoir. Like other producing states, Kansas has enacted a regulatory scheme to ensure the orderly development of its natural resources, to prevent the wasteful production of oil and gas, and to protect the correlative rights of mineral owners. One aspect of this regulatory scheme involves the handling of overproduction and underproduction of natural gas, the subject of the proration order currently under attack (for further discussion of this issue, *see infra* pp. 22-24).

The need for states to prevent the wasteful and uneconomic dissipation of petroleum resources arises in large part (though not exclusively) from the nature of oil and gas property interests:

> The common law privilege of draining a neighbor's land, and the attending necessity of protecting against such drainage by producing from offset wells, combine to cause a great deal of unnecessary drilling, and bring about haphazard production in amounts having no relation whatever to the requirements of the markets. Obviously, such disorderly methods result in economic and physical waste, and are the main sources of the evils usually attributed exclusively to the law of capture.

Hardwicke, *The Rule of Capture and its Implications as*

Applied to Oil and Gas, 13 Tex. L. Rev. 391 (1935).

State prorationing of common reservoirs has long been recognized as a legitimate exercise of state power to conserve natural resources and to protect correlative rights of mineral owners. *See Ohio Oil Co. v. Indiana*, 177 U.S. 190 (1900); *Bandini Pet. Co. v. Superior Ct.*, 284 U.S. 8 (1931); *Patterson v. Stanolind Oil & Gas Co.*, 305 U.S. 376 (1938). State proration regulations are a means to try "to adjust the many conflicting interests which grow out of the rule of capture and its implications." *Railroad Commission of Texas v. Rowan & Nichols Oil Co.*, 310 U.S. 573, 580 (1940). The right of a person to produce and acquire ownership of gas is "subject to the reasonable exertion of the power of the state to prevent unnecessary loss, destruction, or waste." *Champlin Refining Co. v. Corporation Commission*, 286 U.S. 210, 233 (1932). As this Court stated in *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179, 185 (1950), "[i]t is now undeniable that a state may adopt reasonable regulations to prevent economic and physical waste of natural gas".

B. The Kansas Order Solely Regulates "Production" and "Gathering."

The Kansas order at issue regulates only the "production or gathering" of natural gas, an area expressly exempted from the federal regulatory domain by §1(b) of the NGA, 15 U.S.C. §717(b). "Production" and "gathering" are terms referring to the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution. *Colorado Interstate Gas Co. v. Federal Power Comm'n*, 324 U.S. 581, 598 (1945); *Interstate Natural Gas Co. v. Federal Power Comm'n*, 331 U.S. at 689-93. The Kansas order simply places time limits on the production of underage, and provides producers with the option of reinstating and producing cancelled underage. The Congressional intent in creating this express exemption was to leave all such regulation of production and gathering activities to

the states. For a discussion of the legislative history of the NGA, *see* pp. 9-11, *infra*.

C. The Kansas Order is not Preempted under *Northern Natural* and *Transco*

The analysis in *Northern Natural* and *Transco* does not focus on the state's powers. Instead, the Court seems to apply in both cases a "bright line" test, i.e. whether the order is directed at interstate purchasers:

> The danger of interference with the federal regulatory scheme arises because the orders are unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce.

Northern Natural, 372 U.S. at 92 (emphasis by the Court). In *Northern Natural*, a "bright line" approach may have been attractive given the fact that the state's order was directed at interstate purchases, and the Court found an "occupied federal field" in the comprehensive scheme intended by Congress when the NGA was enacted:

> The Congress enacted a comprehensive scheme of federal regulation of "all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company."

372 U.S. at 91 (citation omitted). In *Transco*, the Court was confronted with the argument that this scheme was narrowed by the Natural Gas Policy Act of 1978, 15 U.S.C. §3301 *et seq.* ("NGPA"). The *Transco* Court reaffirmed the notion of an "occupied field" (*see infra*, p. 8).

The present Kansas order is not preempted under *Northern Natural* and *Transco* under two lines of thought. First, the Court should reconsider its preemption analysis in these two cases since it does not focus on the state action

and sets standards that the states cannot meet whether or not the states act under their rightful conservation and correlative rights power. Second, even if the preemption analysis used in *Northern Natural* and *Transco* is correct, the present Kansas case is distinguishable.

1. The Court Should Reconsider its Preemption Analysis in *Northern Natural* and *Transco*.

a. The "Bright Line" Test is Not Useful Because it Does Not Focus on the State Action.

Any "bright line" test that invalidates state orders by focusing on where the orders are directed is inconsistent with accepted preemption principles. The key question should be the reason for and impact of the state action. It is the state action itself which should be scrutinized for consistency with the accomplishment of the federal purposes. Whether the State's order is directed at pipelines is irrevelant, as the dissenters indicate in both *Northern Natural* and *Transco*. 372 U.S. at 100 (Harlan, J., dissenting), 106 S. Ct. at 723 (Rehnquist, J., dissenting).

Indeed, the Court in *Northern Natural* indicates that, while the troublesome category is orders directed at interstate purchasers and wholesalers for resale, not all such orders would be preempted. "The former [conservation measures directed at interstate purchasers and wholesalers for resale] cannot be sustained when they threaten, as here, the achievement of the comprehensive scheme of federal regulation." 372 U.S. at 94. Presumably, such conservation measures would be acceptable so long as they did not threaten the federal scheme.

b. The Court Should Reconsider its "Occupied Field" Analysis in Light of the Plain Congressional Intent.

After applying the "bright line" test, the Court decided *Northern Natural* in the context of interference with a field occupied by the NGA. The *Transco* case arose following the enactment of the NGPA and also employed occupied field analysis. One question in *Transco* was whether the NGPA

altered the federal scheme in a way which would change the *Northern Natural* analysis, and the answer was no. "The NGPA does not constitute a federal retreat from a comprehensive gas policy. Indeed, the NGPA in some respects expanded federal control...." *Transco*, 106 S. Ct. at 716.

1. Congress has not so Completely Occupied a Field of Government that State Proration Orders are Foreclosed.

If Congress evidences an intent to occupy a given field, any state law falling within that field is preempted. *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Comm'n*, 461 U.S. 190, 203-04 (1983); *Fidelity Federal Savings & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 153 (1982); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). However, Congressional intent to preempt state regulation should be *inferred* only where the comprehensiveness and pervasiveness of the federal regulation *precludes* supplementary state regulation, where the federal interest is sufficiently dominant, or where the goal of the federal law and the character of the obligations imposed by it reveal the same purpose. *See Schneidewind v. ANR Pipeline Company*, 108 S. Ct. 1145, 1150 (1988); *International Paper Co. v. Ouellette*, 107 S. Ct. 805, 811 (1987); *Transco*, 106 S. Ct. at 715-16; *R. J. Reynolds Tobacco Co. v. Durham County, N.C.*, 107 S. Ct. 499, 511 (1986); *Hillsborough County v. Automated Medical Laboratories, Inc.*, 471 U.S. 707, 713 (1985); *Rice v. Santa Fe*, 331 U.S. at 230. Complexity and comprehensiveness of federal regulations alone is an insufficient basis for inferring preemptive intent. *California Coastal Commission v. Granite Rock Company*, 107 S. Ct. 1419, 1426 (1987); *Hillsborough*, 471 U.S. at 712. Rather, this Court requires a "clear and manifest purpose" of Congressional intent to preempt before invalidating state action. *Puerto Rico Department of Consumer Affairs v. Isla Petroleum Corporation*, 108 S. Ct. 1350, 1355 (1988).

This Court invalidated the orders directed at interstate

gas purchasers in *Northern Natural* and *Transco* because the Court believed that the burden those orders placed on those purchasers impermissibly interfered with the federal scheme. However, the express legislative intent and this Court's prior holdings indicate it is not a reasonable inference that Congress "left no room" for state orders that promote conservation and protect correlative rights.

The legislative history of the NGA establishes that Congress did not intend to preempt or interfere with the states' role in conservation and correlative rights:

> There is no intention in enacting the present legislation to disturb the States in their exercise of such jurisdiction. However, in the case of sales for resale, or so-called wholesale sales, in interstate commerce . . . the legal situation is different. Such transactions have been considered not to be local in character and, even in the absence of congressional action, not subject to State regulation.... The basic purpose of the present legislation is to occupy this field in which the Supreme Court has held that the States may not act.... The bill takes no authority from State commissions, and is so drawn as to complement and in no manner usurp State regulatory authority, and contains provisions for cooperative action with State regulatory bodies.

H.R. Rep. No. 709, 75th Cong., 1st Sess. 1-2 (1937) (Report of the House Committee on Interstate and Foreign Commerce on H.R. 6586).

The legislative process that produced the NGA spanned three years. The historical record is filled with affirmations that the NGA was necessary solely to fill a discrete regulatory gap, protection of gas consumers from overcharges for interstate gas transportation and certain interstate sales of natural gas, and was not intended either as a conservation measure or to disturb state power over conservation. The

Court had held that the states were prohibited from regulating rates charged for interstate service, noting that "if such regulation is required, it can only be attained by the exercise of power vested in Congress." *Public Utilities Commission v. Attleboro Steam and Electric Company*, 273 U.S. 83, 90 (1927).

Without a doubt, concern for the rampant waste of gas prevalent at the time was a topic of discussion during the legislative process. Dozier A. DeVane, then Solicitor General of the Federal Power Commission, played a major role in drafting the legislation that eventually became the NGA. When questioned by Congressman Cole of Maryland why the bill did not address conservation concerns, Mr. DeVane replied, "There is some question as to the constitutionality of any act of the Federal Government that may attempt to regulate that matter.... The general opinion is that it can best be handled by State compacts." *Natural Gas Act: Hearing on H.R. 11662 before a Subcommittee of the Committee on Interstate and Foreign Commerce, House of Representatives*, 74th Cong., 2d Sess. 35, 36 (1936) ("1936 Hearings").

The Federal Trade Commission, among others, shared Mr. DeVane's view:

> The Federal Trade Commission report is replete with references to the wastage of natural gas under existing control, and to methods adopted to relieve this situation. This, too, the Trade Commission feels, is primarily a matter calling for action by the states.

Memorandum on the Necessity for Federal Regulation of Interstate Transportation of Natural Gas, as disclosed by Reports of the Federal Trade Commission, other Reports made pursuant to the Authority of Congress, and Decisions of the Supreme Court of the United States, submitted April 15, 1936, 1936 Hearings at 155.

Pipeline companies agreed that the proposed legislation

was "a pipeline control bill and not a conservation measure." 1936 Hearings at 111 (statement of Floyd C. Brown, Vice President and General Manager of the Natural Gas Pipeline of America and Texoma Natural Gas Company). "In the light of recent developments we doubt that it would be necessary for the Federal Government to take a hand in conservation problem[s]." *Id.* at 112.

The legislative history of the NGA clearly indicates that the Congress considered conservation issues such as those addressed by the present Kansas order, were aware of state regulation of natural gas conservation, and consciously decided to leave this state power undisturbed. Furthermore, this Court has recognized the validity of state power to achieve conservation goals many times since the enactment of the NGA. *E.g., Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. at 185-86. The Court, in discussing the NGA, has said:

> Clearly, among the powers thus reserved to the states is the power to regulate the physical production and gathering of natural gas in the interests of conservation or of any other consideration of legitimate local concern. It was the intention of Congress to give the states full freedom in these matters.

Interstate Natural Gas Co. v. Federal Power Comm'n, 331 U.S. 682, 690 (1947). The *Northern Natural* Court reaffirmed "[t]here is no doubt that the States do posses power to allocate and conserve scarce natural resources", including natural gas, upon and beneath their lands. 372 U.S. at 93. While this Court has held that the NGPA did not narrow the comprehensiveness of the federal scheme established by the NGA, *Transco*, 106 S. Ct. at 716, House Energy Committee Chairman John Dingell pointed out in 1978 that Congress and the NGPA continued to expressly recognize state production regulation authority:

> The legislation [NGPA] does not contemplate that FERC will intrude into the traditional conservation functions performed by the states.

> This is a matter reserved to the state agencies who, in the exercise of their historical powers, will continue to regulate such matters as drillings, locations, completion techniques, production rates, etc. Of course, the Secretary of Energy is authorized under Section 505 to intervene as a matter of right in state proration proceedings. This intervention authority, however, does not grant the Secretary any substantive powers or displace any state authority.

124 Cong. Rec. 38,366 (1978) (statement of Rep. John Dingell).

ii. The "Occupied Field" Analysis in *Northern Natural* and *Transco* Sets Standards that the States Cannot Meet.

The Court's analysis in *Northern Natural* and *Transco* concerned whether potential price effects of the state's orders interfered with the comprehensive federal scheme. One interpretation is that the Court concluded that *any* price effect, direct or indirect, was to be viewed as sufficiently threatening to interstate purchases to preempt the state action.

However, the Court recognized (both the majority and the minority) that the "aim of federal regulation remains to assure adequate supplies of natural gas at fair prices, but the NGPA reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand." *Transco*, 106 S. Ct. at 716. The Court in *Transco* focused on the concern that the state's exercise of its conservation authority would have the effect of increasing consumer prices. It was concerned that Mississippi's order threatened to distort the market by artificially increasing supply and price. *Id.* at 718.

The Court should look carefully at this analysis upon review of the present case. If the test is whether a state's action with respect to its conservation or correlative rights

authority has indirect price effects on interstate purchases, the Court has designed a standard which the states cannot meet *whether or not* they properly exercise jurisdiction in these areas.

In any essentially unregulated market place where natural market forces prevail, price is affected by changes in supply and by changes in the costs of production. Even small changes in supply availability theoretically will yield small price fluctuations, at least in local markets. Therefore, any action by the states which changes production rates will affect price to some extent. In addition, regulation of virtually any type will change the costs of production and therefore affect price.

However, the *failure* of the states to exercise authority will also have price effects. Reservoir mechanics tend to define an optimal rate at which a reservoir needs to be produced to maximize economic recovery of the resource over time. If that production rate is exceeded, or in some reservoirs, if the rate of production varies between wells, pressure change can prevent primary recovery of portions of the reserve, thereby forcing the use of expensive secondary and tertiary recovery techniques or, in some cases, rendering gas unrecoverable. The price effect of the lack of state oversight in this area is clear: the resource becomes scarce sooner and price rises accordingly.

It is clear from the experiences of the early-discovered natural gas and oil fields that market forces are not, in and of themselves, sufficient to insure efficient production rates. If no law controls drainage, concerns about property rights tend to force interest owners to rush to recover their share, regardless of the impact on total recoverable reserves. A free and efficient *commodity* market may well be possible, but the concept is of limited utility in the production arena.

The failure of states to perform traditional regulatory functions will undermine mid-to-long term supply integrity, allow waste to occur, leave property rights without protection and, ultimately jeopardize our national security

(to the extent that security is dependent on energy independence).

The special physical qualities of natural gas and its discovery locations demand reservoir and production regulation by state regulatory agencies. Because of these qualities, the Court must refine its price effects test for natural gas to include a standard for judging onerous or "distortive" market interference. There will be price effects of *any* state action (or inaction) affecting production. State regulation which maximizes efficient reserve recovery and prevents waste-causing drainage wars is critical to the accomplishment of the ultimate federal scheme of adequate supply at lowest reasonable prices.

iii. The Boundaries of the Occupied Field in *Northern Natural* and *Transco* Remain Undefined.

Part of the difficulty in applying the occupied field analysis in *Northern Natural* and *Transco* results from the Court's failure to define the boundaries of the relevant occupied field. An analysis of direct and indirect price effect can have little meaning unless it is clear upon what the state action improperly impacts. Mr. Justice Stone dissented on this point in *Hines v. Davidowitz*, 312 U.S. 52 (1941):

> Little aid can be derived from the vague and illusory but often repeated formula that Congress "by occupying the field" has excluded from it all state legislation. Every Act of Congress occupies some field, but we must know the boundaries of that field before we can say that it has precluded a state from the exercise of any power reserved to it by the Constitution. To discover the boundaries we look to the federal statute itself, read in the light of its constitutional setting and its legislative history.

Id. at 78-79.

2. The Kansas Order Lies Outside any Occupied Field Recognized in *Northern Natural* and *Transco*.

If *Northern Natural* and *Transco* stand for the proposition that *any* order directed at an interstate pipeline is preempted if the order has a direct or even indirect effect on natural gas prices, those cases are easily distinguishable from the present case. The Kansas order lies outside of any occupied field recognized in these prior cases. Since the Kansas order lies outside of any occupied field or identifiable portion of a field, "the matter of which the State asserts the right to act" is not "in any way regulated by [a] Federal Act" and therefore the Kansas order cannot be questioned under an "occupied field" analysis. *Pacific Gas*, 461 U.S. at 212-13 (footnote omitted).

If the Court intended to imply a "bright line" test in Natural, the present Kansas order clearly passes the test in that the order is directed at producers and not interstate purchasers. As a result of Hugoton field rules hearings held by the Kansas Corporation Commission, the field rules were revised in 1983 to provide that underage would be permanently cancelled when underage equal to six times the monthly allowable had accumulated, if the producer did not reinstate the underage within two years, or, if reinstated, the underage was not produced within five years. The rule is "directed to and affects only those who drill for and produce gas from the Hugoton field. It does not require pipeline purchasers to do anything or refrain from doing anything." Brief for the United States and Federal Energy Regulatory Commission at 3 (1986).

Under the Court's analysis in *Northern Natural*, a threshold inquiry is whether the state order is directed at a pipeline. *Transco* simply reaffirmed the *Northern Natural* holding after concluding that the NGPA had not "altered those characteristics of the federal regulatory scheme which provided the basis in *Northern Natural* for a finding of preemption." *Transco*, 106 S. Ct. at 714. Since the order in

the present case is directed at producers, not pipelines, it is not now essential for the Court to clarify its rulings in these prior cases as to the legal status of orders directed at purchasers. For present purposes, these prior cases can simply be cited as precedent that an order directed at a producer is not within any "field" which may have been occupied by Congress. Therefore, if the present Kansas order is to be preempted, preemption must be based upon some other analysis.

D. The Kansas Order and Similar State Orders Do Not Actually Conflict With Federal Law, Nor Obstruct the Accomplishment of Congressional Purposes and Objectives.

Even where Congress has not entirely displaced state regulation over a certain matter, state law is still preempted to the extent it actually conflicts with federal law; that is, when it is impossible to comply with both state and federal law, *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963), or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress. *Hines v. Davidowitz*, 312 U.S. at 67.

1. It is Possible for Interstate Purchasers to Comply With Both State and Federal Law.

It is possible for interstate purchasers to comply with both the Kansas order and federal law. The pipelines need not comply with the Kansas order at all since it is directed only at producers. Furthermore, producers' compliance with the present Kansas order does not in any way prevent interstate purchasers from complying with federal law.

2. The Kansas Order Does Not Stand as an Obstacle to Accomplishment of the Full Purposes and Objectives of Congress.

The geographic nature of the "occupied field" metaphor temptingly implies that a given preemption question can be settled by walking boundary lines that are bright and clearly marked. In the present case, however, the state order does not transgress the boundary of the field defined in *Northern*

Natural and *Transco*. It is therefore appropriate to ask whether it is possible that the Kansas order stands as an obstacle to the accomplishment of the full purposes and objectives of Congress. The Kansas order is not such an obstacle.

Although *Transco* was an "occupied field" decision, the case is of some use for its description of Congressional purposes and objectives regarding federal and state natural gas regulation. This description is relevant to the current case in two respects: (1) both the majority and the dissenters were in essential agreement that the Congressional objective in enacting the NGPA was to provide a "more significant role" for undistorted market forces in the determination of wellhead prices; and (2) the majority opinion is not inconsistent with the dissent's view that an efficiently functioning market depends on the existence of property rights and rules of contract and that such rights and rules have not been promulgated under federal law.

Given the essential agreement of all Justices in *Transco* regarding Congressional objectives, the current case can be resolved in a very straightforward manner: (1) the Congressional objective is that natural gas wellhead prices are to be determined in accordance with free market principles, *i.e.*, "a more significant role" for market forces operating without regulatory "distortion" (*Transco*, 106 S. Ct. at 718); (2) free markets depend on rules of property and contract to function efficiently; (3) Congress has not created a national law of property or contracts to govern natural gas relationships; (4) state proration rules, including the Kansas order, are an integral part of state-administered systems for defining and enforcing property rights in natural gas resources; and therefore (5) the Kansas order does not stand as an obstacle to the accomplishment of the full purposes and objectives of Congress.

a. The Congressional Objective is that Natural Gas Wellhead Prices are to be Determined in Accordance With Free Market Principles, *i.e.* "a More Significant Role" for Market Forces Operating Without Regulatory "Distortion."

The Court in *Transco* seems to be divided as to whether, as a factual matter, the Mississippi Order "distort[ed] the market" (106 S. Ct. at 718 (majority)) or "promote[d] the efficient operation of the market." *Id.* at 723 (Rehnquist, J. dissenting). However, the majority and dissent do not appear to differ significantly as to proper understanding of the Congressional purposes and objectives in enacting the NGPA.

With regard to Congressional purposes and objectives, the *Transco* majority and dissent express very similar views. The majority perceives a "new federal role" of overseeing "a national market price regulatory scheme" (*id.* at 716), and characterizes this as a Congressional intention "to give market forces a more significant role in determining the supply, the demand, and the price of natural gas" (*id.* at 717) and an intention "to move toward a less regulated national natural gas market." *Id.* Similarly, the dissent states the NGPA was intended "to decontrol the wellhead price of natural gas sold to interstate pipelines, allowing prices to rise according to market conditions and causing shortages to vanish." *Id.* at 722.

The Court in *Transco* seems to be divided on only two particulars regarding Congressional purposes and objectives. As shown below, these apparent divisions are not significant. First, the dissent differs with the majority opinion for mentioning "supply" and "demand" (as opposed to "price") as economic variables that Congress intended to decontrol. *Id.* at 722 n.5. But, the majority clarifies in a footnote that its point is simply that "Congress clearly intended to eliminate the distortive effects that NGA price control had had on supply and demand." *Id.* at 718 n.6. This clarification is perfectly consistent with the dissent's view that the Congressional purpose and objective was to bring about a more efficiently operating commodity market by decontrolling wellhead prices.

The other area where the *Transco* Court seems to be divided is not central to the majority's reasoning and is treated by the dissent only in a footnote. This area concerns

the "alleged" (in the dissent's view) Congressional purposes of national uniformity and protection of consumers. Although the dissent does not categorically deny the existence of these "alleged" objectives, the dissent does place these matters in a perspective that is consistent with the theory of Congressional purpose shared by both the majority and the dissent. The dissent provides this perspective with the comment that "[w]hile the congressional desire to *decontrol* prices uniformly throughout the Nation includes an intent to prevent States from enacting regulation to *recontrol* them, it does not imply an intent either to create an anarchistic regulatory gap free from property rights and contract rules, or to create a national law of contracts to govern natural gas relationships." *Id.* at 723 n.6 (emphasis by the Court).

The dissent's comments concerning the continued viability of state property law and contract rules are not inconsistent with the majority opinion.

b. Free Markets Depend on Rules of Property and Contract to Function Efficiently.

It is axiomatic that "a precondition for the establishment of a market is the existence and enforcement of property rights." P. S. Dasgupta & G.M. Heal, Economic Theory and Exhaustible Resources 48 (1979). The dissent in *Transco* recognized, and the majority did not deny, that "[m]arkets depend upon such rules to function efficiently." *Transco*, 106 S. Ct. at 722. Therefore, for the natural gas market to operate without "distortion", some authority, either state or federal, must be responsible for creating and administering property rights regarding the commodity for which that market operates.

c. Congress has not Created a National Law of Property or Contracts to Govern Natural Gas Relationships.

The dissent in *Transco* recognized that the Congressional desires giving rise to the NGPA did "not imply an intent either to create an anarchistic regulatory gap free

from property rights and contract rules, or to create a national law of contracts to govern natural gas relationships." *Transco*, 106 S. Ct. at 723 n.6.

Far from creating a national law of contract, the NGPA impact on contracts was expressly limited to allow the free operation of those contracts where prices did not exceed the maximum lawful price established by the Act. *See* NGPA §101(b)(9), 15 U.S.C. §3311(b)(9); *Pennzoil Co. v. FERC*, 645 F.2d 360, 375 (5th Cir. 1981), *cert. denied* 454 U.S. 1142 (1982) ("[T]his Court holds that section 101(b)(9) is Congress' express and specific intent not to preempt the ability of private persons to contractually govern their relationship." 645 F.2d at 375.). Rather than creating a national law of property governing rights in natural gas reservoirs, the NGPA gave the Secretary of Energy the right to *participate* in state prorationing proceedings that are conducted to administer rights in such reservoirs. *See* NGPA §505, 15 U.S.C. §3415.

Not surprisingly, the legislative history of the NGPA fully supports the view that Congress did not intend to abolish rules of property regarding natural gas or to create a federal law of property and contract to govern in this area. According to Energy Committee Chairman Dingell, the NGPA "does not contemplate that FERC will intrude into the traditional conservation functions performed by the states" and the Secretary of Energy's authority to intervene in state proration proceedings "does not grant the Secretary any substantive powers or displace any state authority." 124 Cong. Rec. 38,366 (1978).

The courts have also held that neither the NGA nor the NGPA manifest "a congressional objective that cannot be attained without the application of a federal common law." *City of New Orleans v. United Gas Pipe Line*, 390 F. Supp. 861, 865-66 (E. D. La. 1974), *cited in Pennzoil Co. v. FERC*, 645 F.2d at 385 (federal law remains interstitial and federal common law of contracts not warranted). Thus it has been held that in determining whether area rate clauses provide

sufficient contractual authority to collect NGPA prices, the FERC "must take account and follow any differences with general contract law that the appropriate state contract law may have." *Pennzoil Co. v. FERC*, 645 F.2d at 383-84.

Litigants apparently have never argued that the "rule of capture" or state-administered modifications of this long-standing rule of property have been abolished by Congress. Furthermore, courts have consistently decided that Congress has not done so. *Colorado Interstate Gas Co. v. Federal Power Comm'n*, 324 U.S. at 601-03 (states retain control over "drilling and spacing of wells and the like"); *Federal Power Comm'n v. Panhandle Eastern Pipe Line Company*, 337 U.S. 498, 509 n.14 (1949) (F.P.C. forbidden to require "allocation of production to interstate pipelines"); *id.* at 512-13, n.17 and accompanying text (citing laws of Kansas, Texas and other states as examples of "broad and elaborate" state powers which Congress intended to preserve); *id.* at 509-13 (NGA designed to supplement, not reduce, state power); *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392, 402-04 (1965) (holding that a conventional wellhead purchase recast as a sale of substantially developed leases for resale in interstate commerce is subject to F.P.C. jurisdiction while reaffirming state regulatory power in furtherance of conservation or other legitimate state concerns); *California v. Southland Royalty Co.*, 436 U.S. 519, 526 (1978) (statutory obligation to continue service survived expiration of contract and "bound all those *with dominion and power of sale* over the gas") (emphasis supplied); *Shell Oil Co. v. FERC*, 566 F.2d 536, 540 (5th Cir. 1978), *aff'd per curiam*, 440 U.S. 192 (1979) (FERC attempt to impose "prudent operator" standard on producers would violate production and gathering exemption of NGA).

FERC decisions also uphold the principle that Congress has abolished neither the rule of capture nor state-administered modifications thereof. *E.g., Panhandle Eastern Pipe Line Company v. TXO Production Corp., et al.*, 34 FERC ¶ 61,292 (Order Dismissing Complaint Issued February 28, 1986); Panhandle Eastern Pipe Line Company

v. TXO Production Corporation, et al., 36 FERC ¶61,182 (Order Denying Rehearing Issued August 5, 1986). As the Commission said in denying rehearing in *Panhandle*:

> If the Commission were to adopt the theory ... that gas which has migrated from under a dedicated lease and been produced from non-dedicated leases is dedicated gas, the authority of the states to allocate production rights among owners of gas in a common reservoir would be substantially undermined. *Any such attempt to extend Commission jurisdiction over field production operations is unnecessary and would, in the Commission's judgment, represent an unwarranted and legally unquestionable intrusion into matters properly subject to state regulatory control.*

Id. (emphasis supplied).

d. **State Proration Rules, Including the Kansas Order, are an Integral Part of State-Administered Systems For Defining and Enforcing Property Rights in Natural Gas Resources.**

In Kansas, Texas, Louisiana, New Mexico, North Dakota, and Oklahoma, and some other states, property rights in oil and gas resources are defined and enforced so as to create a middle path between two conceivable property systems: (1) a pure common property system, epitomized by the rule of capture, where an individual's property interest consists of a right not to be excluded from the oil or gas in a common reservoir, and (2) a pure private property system, where the property interest consists of a right to exclude others from a defined portion of the oil or gas in a common reservoir. States have steered a middle course because experience has shown that neither extreme is satisfactory. The first alternative, an unrestricted rule of capture, leads to economic inefficiency and the waste of natural resources. The second alternative, an absolute right to exclude others from a defined portion of the resource, is neither realistic

(given inherently limited knowledge concerning the quantity of the resource while in the ground) nor particularly attractive as a matter of equity (given the fact that the common law tradition recognized a common property system where the rule of capture was considered to be fair play). A pure private property system could, for example, inhibit the availability of natural gas in the marketplace. Primarily for conservation reasons, many states have enacted compulsory unitization laws, but even unitization laws frequently retain features of a common property system and do not provide an absolute right to exclude others from a defined portion of the resource. *See* Allison, *et al., Transcript of Proceedings of the Workshop on Natural Gas Prorationing and Ratable Take Regulation*, 57 Univ. Colo. L. Rev. 317, 363-70 (1986).

The fact that states, in deciding what rules of property to recognize and enforce, are guided by considerations of equity and resource conservation, does not alter the fact that the entire amalgam of a state's spacing regulations, regulation of production rates and priorities, demand allocation (including balancing rules), and other such matters constitutes an administrative system that implements a property right regime falling between the common property and private property paradigms.

The Supreme Court has long recognized that state production regulations are integral to the existence and enforcement of property rights:

> [R]egulations of natural deposits of oil and gas and the right of the owner to take them as an incident of title in fee to the surface of the earth ... is ultimately but a regulation of real property, and they must hence be treated as relating to the preservation and protection of rights of an essentially local character.

Ohio Oil Co. v. Indiana, 177 U.S. 190, 212 (1900).

The Court also has recognized that the property regimes administered by states with respect to petroleum resources

are a middle-ground between common property and private property concepts. For example, the Court has commented that:

> In Texas . . . the holder of an oil lease "owns" the oil in place beneath the surface. . . . But equally recognized is the "rule of capture" which subjects the lessee's interest to his neighbors' power to drain his oil away. Therefore, to speak of ownership in its relation to oil, is to imply a contingency of control not applicable to ordinary interests in realty.

Railroad Commission of Texas v. Rowan & Nichols Oil Co., 310 U.S. at 579.

The middle course between a pure rule of capture and a pure private property regime is perhaps nowhere better illustrated than in rules regarding overproduction and underproduction. A well is overproduced when it has produced more than its prorata share during a given amount of time; a well is underproduced when it has produced less that its prorata share over a given period of time. A typical state oil and gas regulatory body has discretion to permit wells to continue producing despite their overproduced status or to permit underproduced wells to "make-up" their underproduction in the future, within certain limits on the exercise of this discretion. The Kansas order in question is similar in that limits are placed on a well's ability to continue producing after reaching an overproduced status and on a well's ability to make-up underproduction indefinitely.

The fact that states limit the production of overproduced wells illustrates that the rule of capture has been modified. The fact that states limit the time for making up underproduction illustrates that the rule of capture has not been repealed and that states have not established a pure private property regime for gas in common reservoirs.

e. The Kansas Order Does Not Stand as an Obstacle to the Accomplishment of the Full Purposes and Objectives of Congress.

As the previous discussion has demonstrated, the Congressional objective in passing the NGA and the NGPA was not to deny states the right to regulate the production and conservation of natural gas (in the interests of conservation and protection of correlative rights) or to prohibit all actions that might affect the price of gas, but rather to assure that market forces, operating without regulatory distortion, play a more significant role in determining wellhead prices. Free, "undistorted" markets depend on rules of property and contract to function efficiently. Congress has neither created such rules on its own motion nor abolished state-administered systems that define and enforce such rules. Since the Kansas order is an integral part of such a legitimate state-administered system, the order does not stand as an obstacle to the accomplishment of the full purposes and objectives of Congress.

E. The Kansas Order Does Not Violate the Commerce Clause of the United States Constitution.

The Kansas rules regarding make-up of underproduction are applied to wells dedicated to interstate commerce and to wells not dedicated to interstate commerce. The regulation is therefore evenhanded. Since the purpose and function of the Kansas regulatory program is clearly to prevent waste and establish property rights, the effects on interstate commerce must be viewed as incidental. Therefore, any question regarding a burden on interstate commerce is "one of degree." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

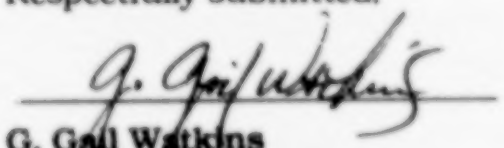
The Kansas order does not place a significant burden on interstate commerce. As discussed above, the Kansas order is an integral part of a state-administered system which is a necessary underpinning to the very existence of the free market environment contemplated by the Commerce Clause. U.S. Const. Art. I §8, Cl. 3. Therefore, the *Peerless*

case should control the present case. *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) ("It is now undeniable that a state may adopt reasonable regulations to prevent economic and physical waste of natural gas." *Id.* at 185).

V. Conclusion

The Court should affirm the decision of the Kansas Supreme Court.

Respectfully submitted,



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